

# A Strategic Analysis of Sabre's Tour Distribution in Canada

by

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### **Title of Thesis/Project/Extended Essay**

A Strategic Analysis of Sabre's Tour Distribution in Canada

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## **ABSTRACT**

This project is concerned with a strategic analysis of Sabre's role within the quickly evolving travel distribution industry, in North America. Particular attention is paid to the distribution of tour products in Canada via the travel agency channel.

The analysis is in four parts: an external review of the industry, an internal analysis of Sabre, a fulcrum and a solution analysis. The fulcrum analysis discovers the attractiveness of the tour distribution industry in Canada to Sabre, and Sabre's competitive position within it. The solution analysis places recommendations against a background of discovered scenarios, and using a multiple accounts evaluation method for a recommendation.

The project recommends that Sabre merchandizes as much tour content as possible, and bypasses the switch technology providers to lower costs and increase margins. Some ownership of the tour distribution responsibility should be assigned from headquarters to the Canadian field operation, and a business case provided.

## **DEDICATION**

This project is dedicated to my wife Anne, and my children Ella, Sylvie and Lewis. I missed them during the last two years of part time study. I have been successful in large part due to their support and understanding.

## **ACKNOWLEDGMENTS**

I would like to acknowledge Dr. Elicia Maine for her guidance throughout this project, and Stephanie Hayes for her assistance. I would also like to acknowledge the support and encouragement that many individuals within Sabre Holdings provided me.

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# **1 INTRODUCTION**

## **1.1 Strategic Problem/Issue**

There are many issues that confront firms that compete for travel distribution revenues. New technologies provide suppliers with more choices for their distribution, and consumers have responded by accessing new alternative channels for content and places of purchase. There are imminent US government regulations that may change the conditions of supply. The worldwide decrease in demand for travel products since 2000 is forcing cost cutting measures and re-evaluations of alliances and partnerships. These conditions are applying pressure to all of the players in the travel arena, so that the industry is witnessing the emergence and adoption of new technologies and business models. This project is concerned with evaluating a number of alternatives for Sabre Holdings to pursue, with respect to a particular line of business: the distribution of tour travel products in North America, and specifically for the agency channel in Canada.

## **1.2 Sabre Holdings: Basic Facts**

The SABRE airline reservation system was owned by the AMR Corporation for many years, in its American Airlines Division. The idea for an airline reservation system came into being on an American Airlines flight in 1953, when an American Airline executive sat beside an IBM executive and began to discuss the information needs of the travel reservation process. The AMR Corporation subsequently began to build a system, and the SABRE system came into being in 1960. The company is headquartered near Dallas, Texas, and its data processing centre now resides underground in Tulsa, Oklahoma. In 1996 the AMR Corporation completed a partial IPO of its SABRE division, and began trading on the New York Stock Exchange (NYSE) as The Sabre Group (TSG). Also, in 1996, the company incorporated the Sabre Holdings Corporation, and launched Travelocity (an online consumer travel service site) that same year. The IPO completed in 2000, and Sabre purchased a company called Getthere and outsourced all of its equipment to EDS. In 2002 Sabre repurchased all of the outstanding shares in Travelocity. Sabre Holdings (now the firm's name) is an S&P 500 company, located in 65 countries, with approximately 6,500 employees worldwide, 3000 of which are located at the company campus in Southlake Texas. Sabre Holdings is engaged in providing distribution and retailing of travel products and technology solutions for the travel industry. Sabre does this via four business units:

1. Travelocity - a leading online travel service provider
2. Sabre Travel Network - the world's largest electronic network for travel buyers and sellers, primarily travel agencies
3. Getthere - a comprehensive suite of tools for corporations to book and manage travel, and
4. Sabre Airline Solutions - a suite of products to optimize airline operations.

Three of Sabre's four business segments market and distribute travel services and products principally for third party suppliers in exchange for distribution fees.

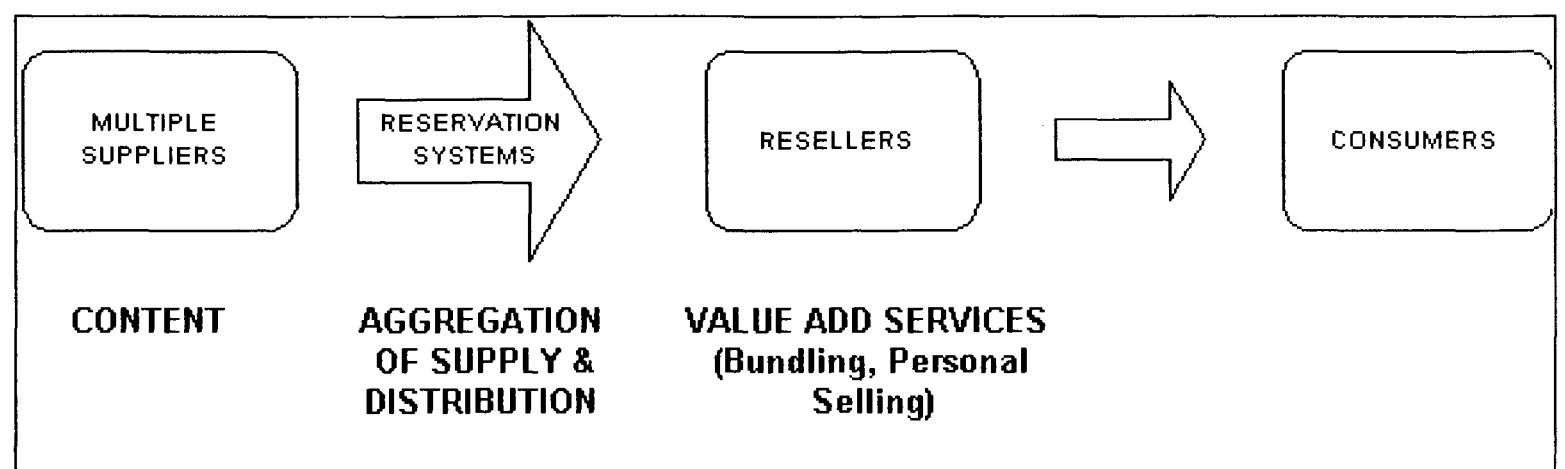


Figure 1: Traditional Generic Travel Distribution Model

*By author*

According to MultexInvestor®,<sup>1</sup> Sabre is situated in the services sector and the personal services industry. Sabre's financial snapshot is as follows, on Figure 2. The distribution portion of Sabre Holdings that is focussed on buyers and sellers via the travel agency channel, accounts for over three quarters of the firm's revenue<sup>2</sup> (Figure 3).

<sup>1</sup> <http://yahoo.multexinvestor.com/Stock/Overview.aspx>, accessed: June 27, 2003

<sup>2</sup> Sabre Holdings Corporation Annual Report 2002

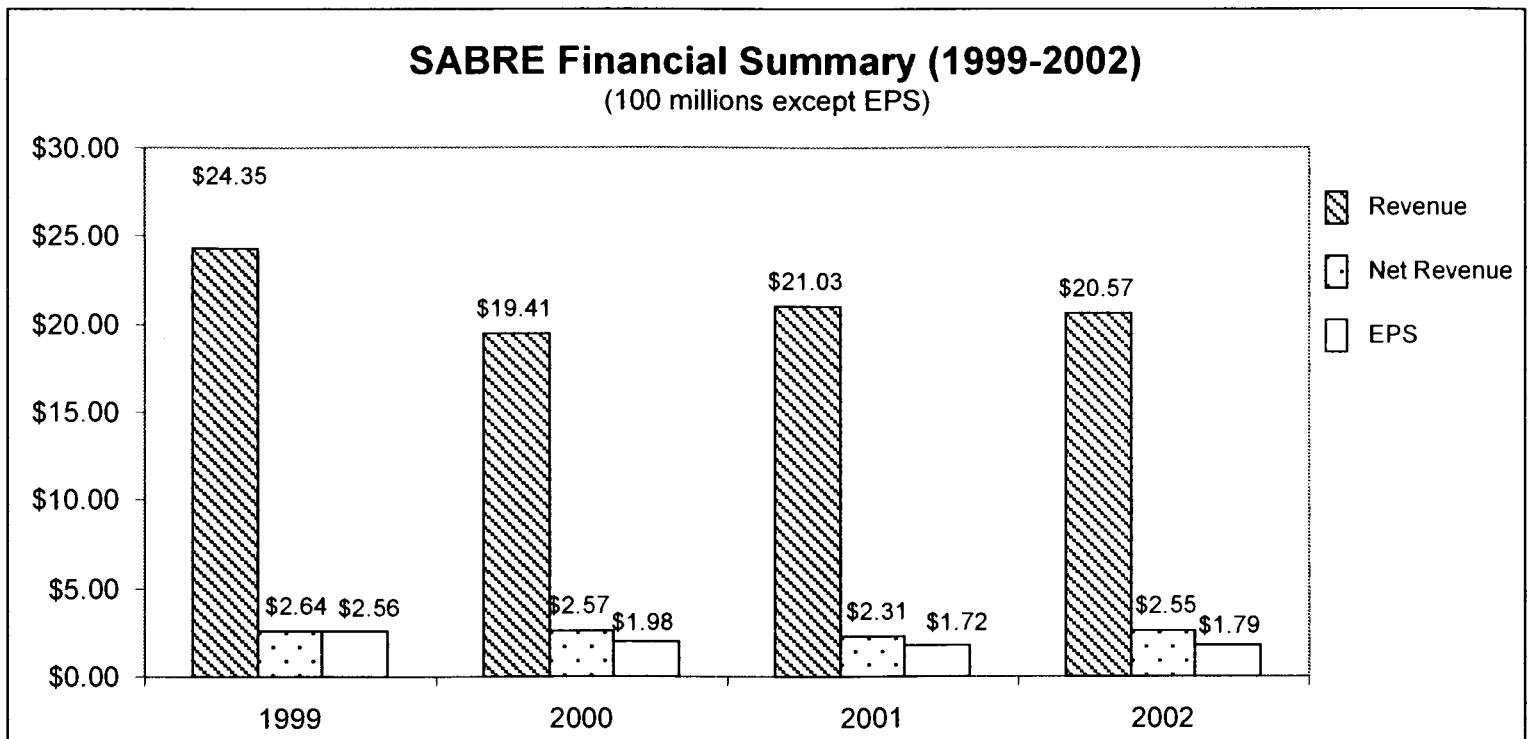


Figure 2: SABRE Financial Snapshot

Figure by author; data compiled from source Sabre Holdings annual reports

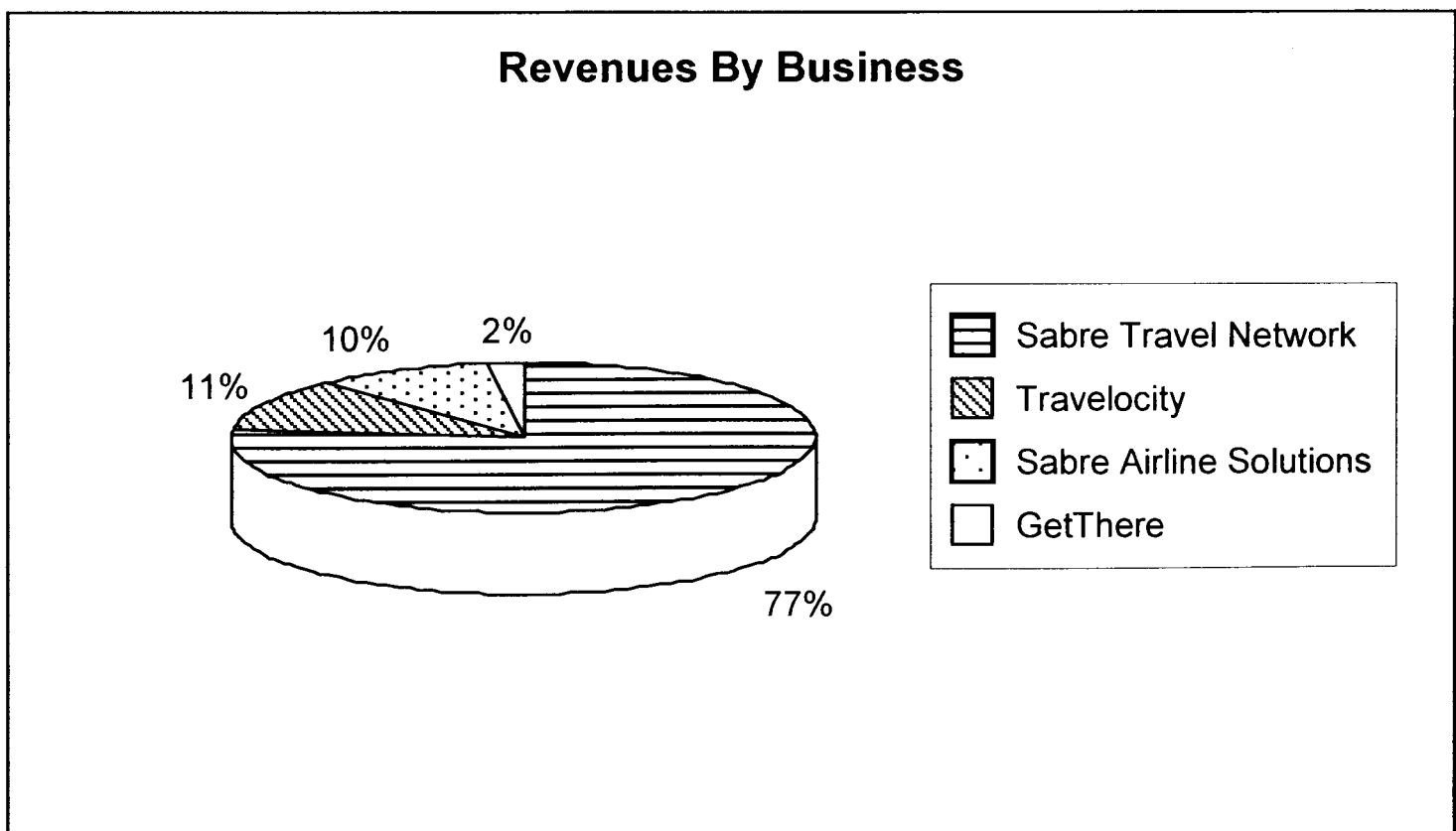


Figure 3: Revenues by Business 2002

Figure by author; data compiled from Sabre Holdings 2002 annual report

## 1.3 Supply Chain

In order to understand the issues facing Sabre Holdings, it is important to understand the history of distribution, as well as the supply chain that has existed for many years. A basic supply chain schematic for the traditional (pre 1995) distribution business follows in figure 4. In the traditional model, the suppliers (chiefly airlines) had two choices of distribution - either via the GDS<sup>3</sup>/Travel Agency channel that provided the broadest reach, or via direct-to-consumers means such as call centres. Reading from left to right: the channel name is indicated, followed by identifying that it is primarily information that flows from the supplier airline, through ATPCO, (the Airline Tariff Publishing Company, which is a fare vendor in charge of distribution of fares and rules to all GDSs), to the GDS distributors, to the desktop point of sale at a travel agency. This is the interface between the suppliers and the consumers, where consumers might shop across a number of agencies. The middle of the figure shows the activities that are occurring: Suppliers are the host, processing inventory and fares, the distributors combine fares and inventory across multiple suppliers, and house the reservations, and the agencies provide shopping selling and fulfillment (e.g. ticketing). The lower part of the figure shows the other channel, the direct offline. This is where an individual airline may sell directly to an end traveller, if for example the route and fare are simple enough not to require any form of travel management, i.e. shopping, combining or fulfillment.

Since 1995, there have been many forces at work in the distribution industry, and there are now many more choices for all players.

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<sup>3</sup> GDS is defined as Global Distribution System.

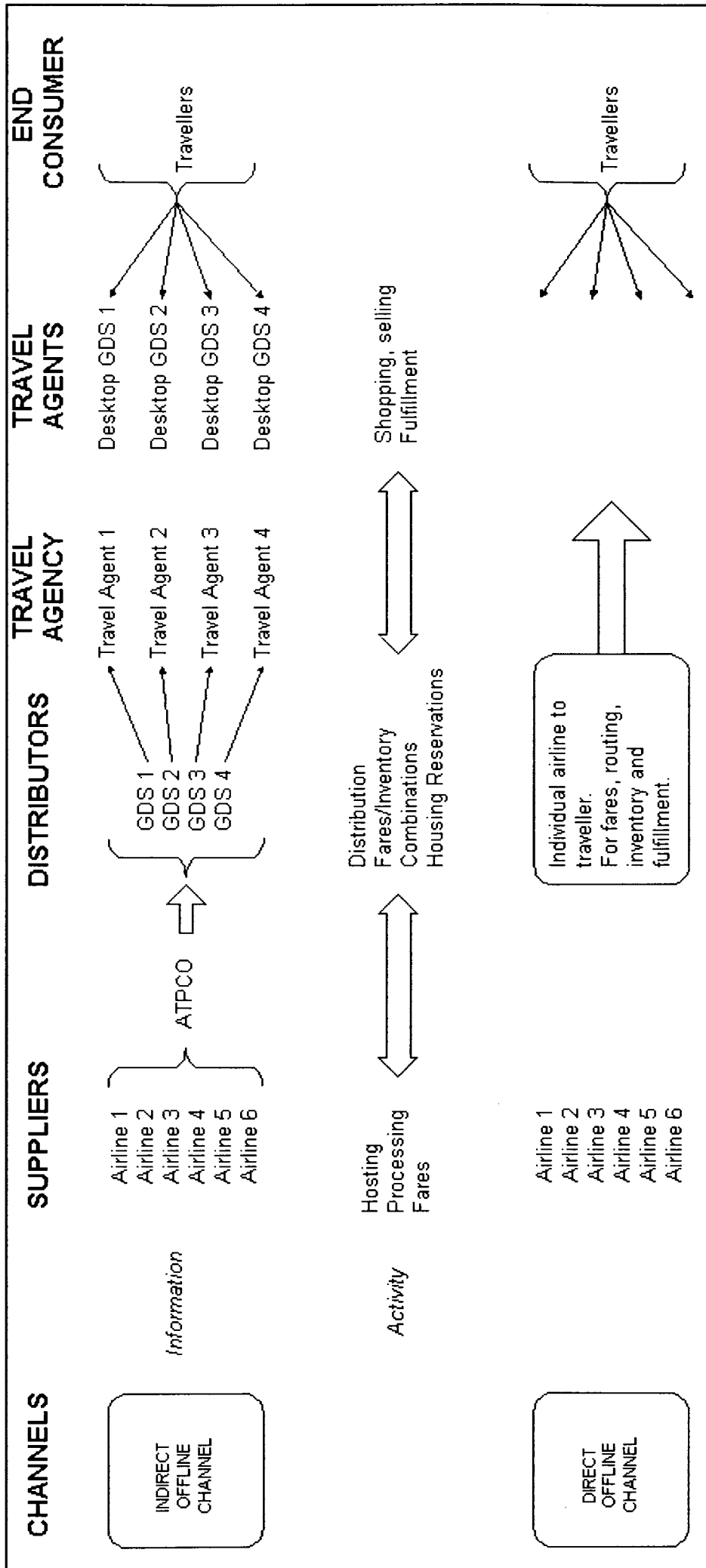


Figure 4: Traditional Supply Chain

By author

## **1.4 Literature Review**

### **1.4.1 Boardman and Vining's Comprehensive Strategic Analysis**

#### **Framework**

This project uses the Boardman and Vining framework for comprehensive analysis. This framework consists of an analysis of the current situation in the industry and the firm, an assessment of the current situation (a fulcrum), and a solution analysis. The purpose is to help analyse how the firm can earn returns in excess of its opportunity costs by describing an issue, assessing it and trying to solve it <sup>4</sup>

### **1.4.2 Industry Evolution**

There are broadly two factors that are identified as fundamental to driving industry evolution: demand growth, and production and diffusion of knowledge <sup>5</sup>. Both of these factors are evident in the travel industry, and especially in tour distribution. There is an upsurge in product innovation activity among technology firms vying for space in the leisure travel business. We can expect to see process innovation and standardization follow once key new products become widely adopted.

### **1.4.3 Supply Chain**

Supply chain management (SCM) is the oversight of materials, information, and finances as they move in a process from supplier to manufacturer to wholesaler to retailer to consumer. Supply chain management involves coordinating and integrating these flows both within and among companies.<sup>6</sup>

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<sup>4</sup> Boardman and Vining (2002), "A Framework for Comprehensive Strategic Analysis" p. 1

<sup>5</sup> Grant (1998), "Contemporary Strategic Analysis." Third Edition. Malden, MA: Blackwell Publishers Inc. p. 242-243

<sup>6</sup> searchCIO.com. [http://searchcio.techtarget.com/sDefinition/0,sid19\\_gci214546,00.html](http://searchcio.techtarget.com/sDefinition/0,sid19_gci214546,00.html), accessed: July 24, 2003



### **1.4.4 Information Technology as Competitive Advantage**

When SABRE was built in the 1950s and 1960s, it was a pioneering proprietary technology that enabled Sabre to innovatively deploy its applications to travel agents' desktops. Subsequent Central Reservation Systems (CRSs) and GDSs used similar technologies to the same ends, though scale was clearly a significant barrier to entry for most firms. That is, the strategic use of information technology (IT) enabled a few large firms to dominate the electronic travel distribution business, and collect healthy rents for many years. A reservation system such as SABRE is often quoted as an example of the benefits other firms could enjoy if they also positioned their IT in a strategic fashion. According to Nicholas Carr, writing in the Harvard Business review in May 2003 <sup>7</sup>, many US firms have spent an increasing amount of money on IT because executives believed that it represented a potential strategic advantage. Carr's argument is that such a proliferation of IT means that it has become a commodity, and cannot be regarded as able to confer strategic advantage. A strategic advantage is more easily obtained based upon the scarcity of a product or service, not its ubiquity. The rise of Internet technologies that are not proprietarily owned means that the GDSs are at risk of losing their competitive advantage as it has been conferred by their IT. In response, the CEO of Forrester Research, George Colony points out <sup>8</sup> that the strategic success of IT was based less upon core IT functionalities than upon the mastery of its uses. That is, high performance and high standardization (which provides for lower costs and higher flexibility) were more important than the IT resource itself. For the GDSs to thrive, they would need to adopt and integrate ubiquitous technology and master its uses.

### **1.4.5 Porter's Five Forces**

According to Michael Porter, the most important determinant of an industry profit potential is the intrinsic power of its buyers and sellers <sup>9</sup>. The Five Forces framework provides an analysis of profitability as it is determined by five sources of competition: substitutes, new entrants, current rivals, as well as the bargaining power of suppliers and buyers. This project also uses a sixth force, that of the threat of regulatory powers to assemble a view of the tour distribution industry's competitiveness. The Porter model, however, is restricted to viewing the

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<sup>7</sup> Carr, N. (2003). "IT doesn't matter." Harvard Business Review, May 2003. p. 5-12.

<sup>8</sup> Colony, G. (2003). "Forrester CEO looks above IT iceberg waterline." <http://www.m-travel.com/30618.shtml>, accessed: June 25, 2003

<sup>9</sup> Porter, M. (2001). "Strategy and the Internet." Harvard Business Review, March 2001. p. 63-77.

industry as a static system, and has as its basis the ‘structure – conduct – performance’ approach to industrial organization economics <sup>10</sup>. While this provides a useful construct, it is important to note that the travel industry is one in which there are many dynamic forces occurring at a rapid pace.

#### **1.4.6 Alternative Methods for Assessing Industry Attractiveness**

The issue at stake is whether industry structure can be used as a guide to the nature of competition and performance, and the history and entrenched business models in travel suggest that it can be. However, researchers at McKinsey & Company determined that game theory approaches might be more appropriate given the dynamic nature of co-dependant players in competitive situations <sup>11</sup>. Therefore, competition is a dynamic process where equilibrium is never reached. Consider Joseph Schumpeter’s theory that ongoing innovation is a central and driving component behind industry evolution <sup>12</sup>. The current distribution industry is in a state of great uncertainty, where innovation and new entrants are challenging the dominant and entrenched players that have provided the industry structure for many years. There are many firms involved in product innovation within the value chains, and this may be followed by process innovation as knowledge diffuses through the industry.

#### **1.4.7 Porter’s Value Chain**

Michael Porter also developed the value chain model <sup>13</sup> for businesses that describes their value creating activities. The primary value activities include: inbound logistics, operations, marketing and sales, and service. Secondary activities include: procurement, technology development, human resource management, and the firms’ infrastructure. The chain is arranged in a linear flow, which works well in describing manufacturing firms. The value chain model is applied in this project to describe the value creating activities in the travel shopping process.

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<sup>10</sup> Grant (1998), “Contemporary Strategic Analysis.” Third Edition. Malden, MA: Blackwell Publishers Inc. p. 70

<sup>11</sup> Grant (1998), “Contemporary Strategic Analysis.” Third Edition. Malden, MA: Blackwell Publishers Inc. p. 70

<sup>12</sup> Grant (1998), “Contemporary Strategic Analysis.” Third Edition. Malden, MA: Blackwell Publishers Inc. p. 71

<sup>13</sup> Porter, M. (1985), “Competitive Advantage, creating and sustaining superior performance.” The Free Press, a division of Macmillan Inc. Chapter 2

That is, rather than view the firm as a linear flow of value creating activities, the shopping process is described as a chain of events where travel firms have the opportunity to create value.

#### **1.4.8 Value Network**

Stabell and Fjeldtsda <sup>14</sup> posit that the activities that are vital to a firms' competitive advantage are industry-dependant, and that a value network is one of three typologies to explain value creation in other environments, especially non-manufacturing environments. A value network describes firms that use technology to link customers and create value in doing so. The following primary activities of a value network describe a GDS well:

a) Network promotion

These are the activities required in order to establish contracts with customers to join the network. In the traditional distribution model, Sabre for many years was split into two 'houses'. One house consisted of airline associates who were charged with winning as many new airline contracts as possible, at different levels (and prices) for connectivity. The other house consisted of the agency side where competition for desktop market share took place. The value proposition here is the amount of content available for an agency to choose from.

b) Service provisioning

These activities are associated with maintaining and servicing the links between customer types, and billing for the value received. The billings are dependant upon the level of connectivity by an airline and the productivity of the agency (i.e. the use of the system).

c) Infrastructure operation

These are the activities associated with maintaining the physical infrastructure, or data processing mainframes.

The secondary value creating activities are the firm's infrastructure, human resources management and technology development. The latter may be concerned with, for example, expanding the communication network, setting standards, and designing new services.

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<sup>14</sup> Stabell, C., Fjeldstad, O. (1998). "Configuring value for competitive advantage: on Chains, shops and networks." *Strategic Management Journal*, Vol 19, p. 413-437

### 1.4.9 Disruptive Technology

A disruptive technology is one that meets the criteria established by Christiansen in the Innovators Dilemma <sup>15</sup>. The disruptive technology theory purports that a “disruptive technology” must have the following three characteristics:

- Disruptive products are simpler, cheaper, with lower margins on a ‘gross dollars per unit’ basis
- These products are first commercialized in insignificant or emerging markets
- Leading customers of an incumbent don’t want to, or can’t, use these products.

It is also often the case that the current market is over serviced for their needs. Dynamic packaging and dynamic pricing have these characteristics: the products presented are cheaper to the consumer and therefore have lower margins on a gross dollar basis. This method is being commercialized by online agencies, which are still an emerging market for distribution, and leading customers for distribution (the largest airlines) are not willing and able to allow re-pricing decisions on the bulk of their inventory. The GDSs serve the major airlines well, with complex fare and routing abilities that provide combinations of airlines and fares. The current business climate, however, is favouring the rise of low cost airlines that have simple fares without complex itineraries and combinations of fare rules.

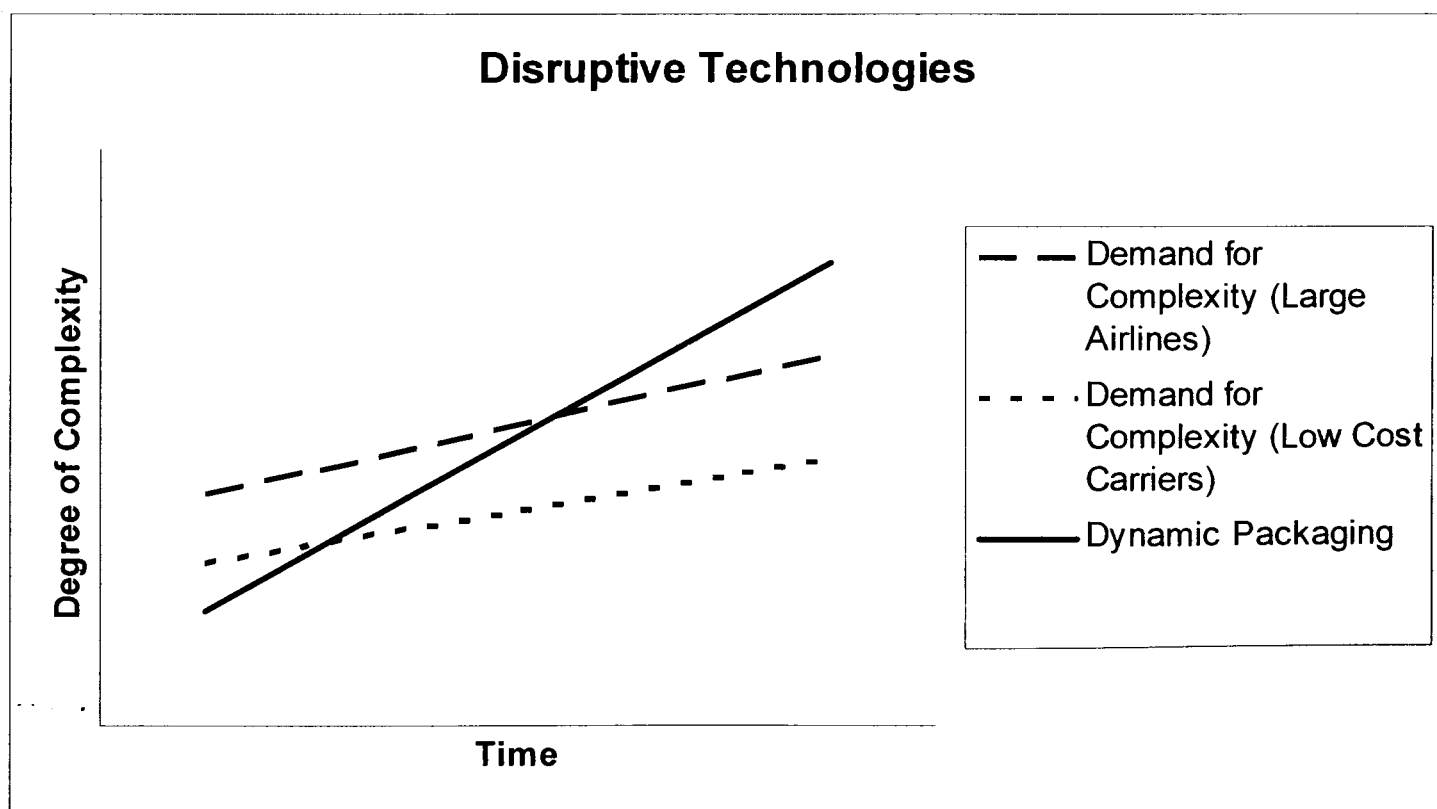


Figure 5: Disruptive Technologies

By author

<sup>15</sup> Christensen, C. (1997). "The Innovators Dilemma." Harvard Business School Press, Cambridge, Mass.

## 1.4.10 Uncertainty and Strategic Planning

The focus of strategic management has shifted from planning processes to the quest for profit, and so the theoretical basis in the field has been driven by analyses of the sources of profit, and factors that affect these <sup>16</sup>. An important factor in the current travel and travel distribution industries is uncertainty. Uncertainty can be graded into levels such as a Level 3 type of uncertainty, according to Courtney, Kirkland and Viguerie <sup>17</sup>. A Level 3 type is one where it is impossible to describe all of the outcomes in detail, but it is possible to predict a likely range, and make plans accordingly. This starts with a choice of strategic posture, which is defined by the authors as the intent of a strategy relative to the current and future state of the industry.

There are three kinds of position: shapers, adapters, and reserving the right to play. Shapers want to create new opportunities by trying to take control of a direction of the market. A strategic posture, however, does not define the action, of which there are three – big bets, options, and no regret moves. Shapers will usually take big bets that can provide big payoffs in some scenarios and large losses in others. Options are moves designed to enable as large as payoff as possible in best case scenarios and minimize losses in worst case ones. No regret moves try to enable payoffs regardless of the scenario that unfolds. In level three situations of uncertainty, shapers will try to move the market in a general direction and make big bets accordingly. Courtney et al, do not recommend a mutually exclusive approach. For example, they say that shapers do not always need to make big bets in order to win, but they must have the credibility to coordinate the strategies of different players around the preferred outcome.

There are methods for analysing the uncertainty in an industry such as scenario planning, game theory, system dynamics, agent based models and real options. Sabre has used scenario planning since 1998, both to analyse uncertainty but also to use it to forecast where profits will be in the future <sup>18</sup>. Schoemaker points out that scenario planning has advantages over different planning methods such as contingency planning, sensitivity analysis, and computer simulations. Contingency planning examines only one uncertainty; sensitivity analysis examines the effect of a change in one variable, keeping all other variables constant, and complex simulation models

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<sup>16</sup> Grant (1998), “Contemporary Strategic Analysis.” Third Edition. Malden, MA: Blackwell Publishers Inc. p. 19

<sup>17</sup> Courtney, Hugh G., Jane Kirkland and S. Patrick Viguerie, (1997). “Strategy Under Uncertainty,” Harvard Business Review, 75 (6): p. 66-79.

<sup>18</sup> Schoemaker, P. (1995). “Scenario Planning: A tool for strategic thinking”. Sloan Management Review, Cambridge, Mass. Winter 1995.

provide a number of outputs as long as the data can be modeled. Scenarios change several variables at a time and include elements that cannot be formally modeled to include subjective interpretations. It organizes those possibilities into narratives that are easier to grasp and use than great volumes of data.

### **1.4.11 Business Strategy**

Business strategy is concerned with how the firm competes within a particular industry - it must establish a competitive advantage over its rivals. Competitive advantage occurs when two or more firms compete within the same market. One firm possesses a competitive advantage over its rivals when it earns a persistently higher rate of profit, or has the potential to do so <sup>19</sup>. Strategy is often understood by managers in firms to be three things: the concept of fit (the relationship between a company and its competitive environment), the allocation of resources among competing investment opportunities, and a long-term perspective where ‘being strategic’ implies paying now and waiting for the investment to bear fruit in the future <sup>20</sup>. Hamel and Prahalad go on to illustrate two points: 1) that there exists in challengers a greater stretch between resources and ambition, which causes accelerated product development cycles, tightly knit cross-functional teams, and a view of competition as encirclement rather than confrontation; and 2) that garnering greater resource productivity can be accomplished by downsizing or leveraging resources across units. Allocating resources among competing businesses and geographies is usual, but leveraging those resources across the firm rather than simply allocating them is a more creative response to scarcity, and is better for morale than downsizing.

### **1.4.12 Balanced Scorecard**

The balanced scorecard is an approach to performance measurement devised by Kaplan and Norton <sup>21</sup>. It is a tool that allows managers to look at their businesses from four perspectives at the same time: Financial, Customer, Innovation and Learning, and Internal Business Perspective. It brings together many seemingly disparate perspectives, goals, and their respective

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<sup>19</sup> Grant (1998), “Contemporary Strategic Analysis.” Third Edition. Malden, MA: Blackwell Publishers Inc. p. 174

<sup>20</sup> Hamel, G., Prahalad, C.K., (1993). “Strategy as Stretch and Leverage” Harvard Business Review (March-April 1993). p. 75-84

<sup>21</sup> Kaplan, R., Norton, D. (1992). “The Balanced Scorecard – Measures that drive performance,” Harvard Business Review, Jan-Feb. p. 71-79

measures into one tool. In 1996, Kaplan and Norton followed this notion up with an article that describes how to use the scorecard strategically <sup>22</sup>. In this article, the authors point to firms that use the scorecard to link long term strategy or visions with short-term action items. Sabre Travel Network (STN) has used a balanced scorecard within the last three years as a means of capturing current strategic initiatives, and tracking them with their goals and measurements, at the field sales and service level. Many of these initiatives and goals are in transition and the systems to capture results have experienced a period of development. Sabre has not used the scorecard as a means to link strategy with actions across all levels of the company. This project uses the Sabre Holdings' corporate strategy for STN as the basis for the balanced scorecard - see section 5.3.

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<sup>22</sup> Kaplan, R., Norton, D. (1996). "On using the balanced scorecard as a strategic management system", Harvard Business review, Jan-Feb. p. 75-85

## **2 INDUSTRY ANALYSIS**

### **2.1.1 Introduction to the Distribution Industry**

The travel industry is defined as the group of firms that supply a market for travel (transportation) goods. These goods are by nature intangible, experiential, non-perishable, and data rich. The supplier firms provide travel components (products) of a travel journey such as air seats, car rentals, hotel nights, cruise cabins, and tour and vacation packages. The purchasers of the products are ultimately the end consumer travellers, and in between are distributors and re-sellers. Within the travel industry there is a distribution industry competing for the fees associated with the ability to distribute travel products from suppliers to consumers.

This project defines the North American travel distribution industry as the market in Canada and the USA for buyers and sellers of travel components that make up a travel journey, which can take place anywhere in the world. These travel components are supplied, distributed and sold to the North American consumer regardless of supplier origin or traveller destination. Many studies of the travel business are country-specific, either from the viewpoint of a nationally based supplier, the purchasing behaviours of domestically based consumers, or the impact of the travel and tourism industry on the domestic economy. The difference is that the latter studies provide information on travel activities related to a particular country, whereas this project examines the businesses that compete for the distribution fees in the market of buyers and sellers of travel products in North America. This market is of interest because it defines the North American travel market from the perspective of supplier distribution. Consider an Asia-based air carrier distributing its product to US consumers booked via a travel agent, or a German rail firm selling to Canadians via its website, or a US tour operator that packages air, car and hotel vacations to Americans visiting Europe. The suppliers of these products require specialist firms for successful marketing, distribution and fulfillment of their products. An understanding of the role of these distributors is critical to an analysis of the travel distribution industry and, within that, the tour distribution business.

### **2.1.2 The Role of Technology: Airline Reservation Systems**

In the 1950s, air travel supplanted rail as the predominant mode of transport in the US, the world's largest travel market. Scheduled airlines had IT requirements for housing their inventory, processing transactions and distributing their products, and they were developing



methods of segmenting their consumers into groups with different demand elasticities. By automating reservation management, and by combining fares with inventory, the airlines were able to build reservation systems that allowed airlines to improve their pricing strategies. By preventing arbitrage between these groups, for example, the airlines were able to practice third degree price discrimination successfully. The first such system was the Semi Automated Business Research Environment (SABRE) built by American Airlines and IBM in 1960, and owned by American's parent, the AMR Corporation. A number of such systems, called airline reservation systems, or CRSs (Centralized Reservation Systems), were subsequently built and owned by a few of the world's largest air carriers. Information Technology (IT) became a source of competitive advantage for the airlines that had such capabilities.

There are primarily two functions for these systems: the hosting of a carrier's inventory and transaction processing, and the distribution of its fares and inventory to consumers. As the airline industry grew, so a market for hosting technology grew until there were over 50 airline reservation systems (as in the current market), some of which now act as hosts for other carriers. SABRE was owned as a reservation system by AMR's American Airlines and acted as that airline's host, selling its services to other carriers. To illustrate, SABRE acts as the host for Aerolineas Argentinas, Galileo hosts United Airlines, Amadeus hosts British Airways, and IBM is the host for Air Canada. Amadeus is the leader in this portion of the airline IT business, hosting over 100 airlines, while approximately 40 airlines use Sabre, Galileo or Worldspan<sup>23</sup>.

In 1976, AMR recognized a new opportunity for the distribution side of the reservation systems - the electronic distribution of travel. The company innovatively deployed its IT resources by installing SABRE in a travel agency in 1976. By 1978, over 1 million fares could be stored in SABRE and distributed, in conjunction with specific inventory, to the travel agency desktop. While scheduled airlines have a choice with respect to their hosting needs, they had been obliged by a series of CRS government regulations during the 1980s and 1990s (in both countries) to participate in all distribution systems equally. "Participation" means that each airline was required to deliver inventory, fares, routing and rules to all of the CRSs in equal measure. The CRSs can then charge the carrier a segment fee for each piece of inventory that is fulfilled. These rulings protected consumer choice by discouraging those reservation systems that had a desktop presence from biasing their displays in favour of the carrier that owned the system. The distribution side enjoyed protection of its supply of travel products, and so there was a race for scaling up and growing market share at the point of sale by developing products that would

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<sup>23</sup> Tunnacliff, I. (2003). "Rumors of Global Distribution Systems are premature" Planning Assumption, 2003, Giga Information Group, Inc.

enable and facilitate travel agency transactions. The costs for such systems are largely fixed and the rate of financial return is higher for a more comprehensive system so the gains were used to fuel growth, thereby improving the informational advantage, and so on. As a result, a few of the reservation systems were able to achieve informational economies of scale and became the primary distributors in the market. As the CRSs enabled automated car, hotel, tour and cruise reservations for their points of sale, they became known as Global Distribution Systems (GDSs). These systems grew to become very large, centralized databases with worldwide networks that contained millions of disparate travel schedules and fares, and developed the logic to combine and present many options. GDSs have developed algorithms that enable rapid response times (measured in milliseconds) to complex itinerary queries involving any of the world's largest travel providers. The GDSs were able to retrieve disparate inventories, fares and routings from multiple databases and produce real time answers to consumer travel queries at a travel agent's desktop. At the same time, the GDSs operated mission critical services to the large airline carriers in the form of distribution and marketing – services that created revenue opportunities. As their desktop market share grew, the GDSs became vital not only for the suppliers of inventory (chiefly the airlines), but also for the travel agent end users who integrated their own internal processing and accounting processes with the distribution technology.

A GDS is a text-based emulation, 'green screen' legacy host-based inventory management system. Sabre originally (and still partly today) used the IBM™ TPF (Transaction Processing Facility) as its operating system. This is an operating system that is specialized for large transaction processing systems such as airline reservations, formerly called Airline Control Program/Transaction Processing, that run on mainframe platforms. It had the unique ability at the time to be able to run wide area networks, and had exceptional scalability and operability characteristics. The connections from Sabre to its travel agency customer desktops were along very secure, protocol-intense and slow speed X.25 telephone lines. For many years, a limited number of large organizations had the capacity (by being bound together in rigid, complex standards such as EDIFACT) to exchange large amounts of information between suppliers, resellers and consumers along telephone lines. With the advent of the Internet, the technology to make phone lines into high-speed data lines, along with web services, there are now more flexible, standard ways to communicate electronically between businesses, especially for messaging, networks, and client GUIs (graphical user interfaces). Technology standards such as UDDI, WSDL and SOAP use XML (Extensible Markup Language) to describe the service and its location, define the interface to the service, and bind the service to the application, respectively.

Universal standards and advances in data communication technology are the keys to achieving large-scale interoperability that has previously been expensive and time-consuming.

This means that the barriers to entry for suppliers and resellers are significantly lowered. Web Services and widespread high speed and high bandwidth connectivity have enabled smaller firms to join large distribution networks. The GDSs can now acquire more content more quickly, and resellers can choose the content and services they desire through a GDS or directly from the supplier. This is clearly a threat to the GDSs that depend on adding value between the suppliers and end consumers. The adoption of web services will enable delivery of innovative and flexible applications and is a significant key to modernizing Sabre's data access layer.

The GDSs act as mediating technologies<sup>24</sup>, which means that they link customers who are interdependent (such as suppliers and travel agencies or end consumers), and enable exchanges between them. The GDSs provide networking services - their key cost drivers are scale and capacity utilization, and key value drivers are functions of the set of customers that are connected. In many ways, the GDSs are positioned to become infomediaries or syndicators. According to the definition provided by Hagel III and Singer in their book *Net Worth*<sup>25</sup> the authors posit that consumers will begin to challenge marketers for control of their own customer information. An information intermediary is a firm that will be able to gather revenue by helping customers protect and enrich themselves through capturing their own information and then selling it to the firms who currently get this data for free. The authors go on to demonstrate that to date there is not a firm that exactly matches their definition, but some firms (such as Amazon.com) are beginning to position themselves in such a way. Sabre is well positioned in that it already stores traveller data and data for the agencies that booked the travellers, for many suppliers. Werbach<sup>26</sup> describes syndicators as a type of infomediary with which a firm brings content together from many sources and makes it available to many distributors through standard formats and contracts. A GDS does this by connecting airlines and other suppliers to travel agents, tour operators and end consumers.

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<sup>24</sup> Thompson, J.D. (1967). "Organizations in action." McGraw-Hill, New York.

<sup>25</sup> Hagel, J., Singer, M. (1999). "Net Worth: Shaping markets when customers make the rules." Harvard Business Press.

<sup>26</sup> Werbach, K. (2000). "Syndication: the emerging model for business in the Internet era," HBS Working knowledge, Harvard Business School. <http://hbsworkingknowledge.hbs.edu>, accessed: June 25, 2003

## **2.1.3 Industry Structure and Business Models**

### **2.1.3.1 Non-Tour Distribution**

Market power in an industry is dependant upon elasticity, concentration, and the extent of collusive behaviour. During the 1990s, the overall demand for US domestic travel grew at a rate of eight percent between 1994 and 2001 <sup>27</sup>, which reflects the population growth (9%) in the US over the same time frame, although leisure travel grew faster at 13%. In addition, the regulation of supply since the 1980s and the development of CRS technology were the driving forces to enable concentration of the players so that there exist only four large distribution firms in North America. The distribution industry's market structure has evolved to be a mature oligopoly. There are a few players (four) with high barriers to entry (scalability costs), essentially for an undifferentiated product (distribution of air seats), which have well-established and integrated systems, and a high degree of information asymmetry. For many years, the majority of an airline's distribution was delivered via the GDS/agency channel and direct-to-consumer was a secondary channel. Classic Cournot duopoly theory suggests that the level of output for a duopolist will be restricted to a level between a monopoly and that of perfect competition, and therefore the duopolist will charge a price higher than the competitive level, and lower than a monopolist. The theory shows that with as few as seven firms participating, the deadweight loss due to Cournot is only 6% of that under monopoly conditions. That is, with only seven firms an oligopolistic market can behave closely to a perfectly competitive one. The distribution industry in North America has only four firms therefore it seems likely that the GDSs have some measure of market or pricing power. For example, the GDSs have been able to raise their booking fees between 2.0-8.7% annually <sup>28</sup>, roughly comparably with one another even in recent times when the demand for travel has slowed and even declined and the airlines have been unprofitable (Figure 10).

The business model for the distribution industry that grew from these circumstances is an airline-centric and 'agency transaction' one. It is supplied by airlines' inventory and funded by airlines' distribution fees primarily to the GDSs on a transaction basis, and travel agencies' earned commissions. In recent years, airlines have cut back on commissions, and the agency channel has adopted a fee for service model. (According to a recent Sabre study, agencies on

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<sup>27</sup> Travel Industry Association 2002, "Domestic Travel Report," Washington DC.

<sup>28</sup> CIBC World Markets Equity Research (June 2003), "Industry Update – GDS regulations: reviewing what's important", p. 7

average earn \$3.60 for each scheduled airlines' published fare ticket sold, or \$8.60 if they have a preferred override in place with the carrier, including an averaged commission amount. The costs to market, sell, issue and account for tickets average \$45.00 per ticket.). The competition for suppliers' distribution revenue is, therefore, a factor of the GDSs' market share on the point of sale (agency) side. The GDSs compete here primarily with 'ease of booking' tools (products) and incentives. The current (May 2003) North America market share of bookings (i.e. revenue) for the GDSs distribution business is as follows:

	<b>Sabre</b>	<b>Galileo</b>	<b>Worldspan</b>	<b>Amadeus</b>
<b>Canada</b>	60.2%	32.1%	5.4%	2.3%
<b>USA</b>	43.6%	20.2%	27%	9.1%
<b>TOTAL NA</b>	45.1%	21.3%	25.1%	8.5%

Table 1: GDS Desktop Market Share in North America

*Figure by author; data compiled from Sabre Holdings 2002 market share report 2002*

### **2.1.3.2 Tour Distribution**

#### **2.1.3.2.1 Introduction**

The tour distribution business is a subset of the 'leisure travel' industry classification, which is a subset of the overall travel distribution industry. Leisure travel is a complex offering of products and services and, in aggregate, represents the market with the highest growth rate in the last decade according to the US based Travel Industry Association (TIA) <sup>29</sup>. It is very difficult to obtain the true size of the business as the market for leisure travel products is very fragmented, the moniker encompasses a wide variety of providers, and there are many individual privately owned leisure firms that do not publish their numbers. The absence of informational standards has meant that there is a lack of cost-effective interoperability, and concomitant scaling up of an information acquirer. There is not an organization or a group that has dominated the tour market in the same way that the Centralized Reservation Systems came to dominate air distribution. There is an organization named TOWARD (Tour Operators and Wholesalers Achieving Real-time Distribution), but this has not yet effectively produced any universal standards. From a data-gathering perspective, "Leisure Travel" usually refers to cruises and packaged vacations. This

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<sup>29</sup> Travel Industry Association (2002) "Domestic Travel Report" Washington DC.

project will focus on products provided by Tour Operators and Wholesalers, excluding cruises but including FIT (Flexible Itinerary Tours) and packages.

Tour travel, packaging, vacation travel or leisure travel are terms which are used interchangeably to describe similar things. Leisure travel usually (but not always) includes the bundling of 2 or more component products that are usually (but not always) sold at one price. For example, the word 'package' or 'holiday' is commonly used in Canada to describe a charter airline ticket sold in conjunction with hotel space at the destination. The word 'tour' is commonly used to describe a value-added additional component (such as sightseeing, or an escort) over and above a package that is built around an itinerary. The firms that provide the bundling of components are called either tour operators or wholesalers, and the difference between them is the commercial terms in which they operate and the types of products they sell. A Tour Operator is defined by the USTOA (United States Tour Operator Association) as a firm that provides planning, packaging, selling, marketing and promotion of multiple vacation elements (components) including air or surface transportation as well as land accommodation. Bundling of multiple components produces outcomes similar to second-degree price discrimination in that it includes 'all or nothing' offers or block pricing, and assumes that consumer tastes are homogenous within and heterogeneous between bundles.

In contrast, a wholesaler will assemble air (scheduled in the US, and often charter in Canada) and hotel, plus any additional components fitted to an individual (FIT) traveller sold at a discount to agencies, usually on net remit terms, based upon volume selling. That is, an agency will request an itinerary from wholesalers, based upon an individual's needs, and create first-degree price discrimination by charging a different price per consumer in order to capture the entire consumer surplus. The wholesalers may shop the GDS-held inventory, or even the tour operator-held inventory, so in most cases the GDS do receive the revenue for these bookings. (The GDS would not gather revenue in the circumstance where, for example, the agency called the wholesaler who used the phone or fax to go directly to a tour operator or charter airline. This activity is difficult to track and estimate in impact, but it is likely to be a small proportion of overall bookings made by wholesalers).

There is another player in the leisure mix of businesses called 'consolidators', which are firms that specialize in 'distressed' air only (usually scheduled airlines) bookings. The carriers control the distressed fares and inventory via the GDS technology so that the booking revenue is normally gathered by the GDS that the agency is contracted with. These bookings are then counted as part of the usual 'air' component, and not the tour.

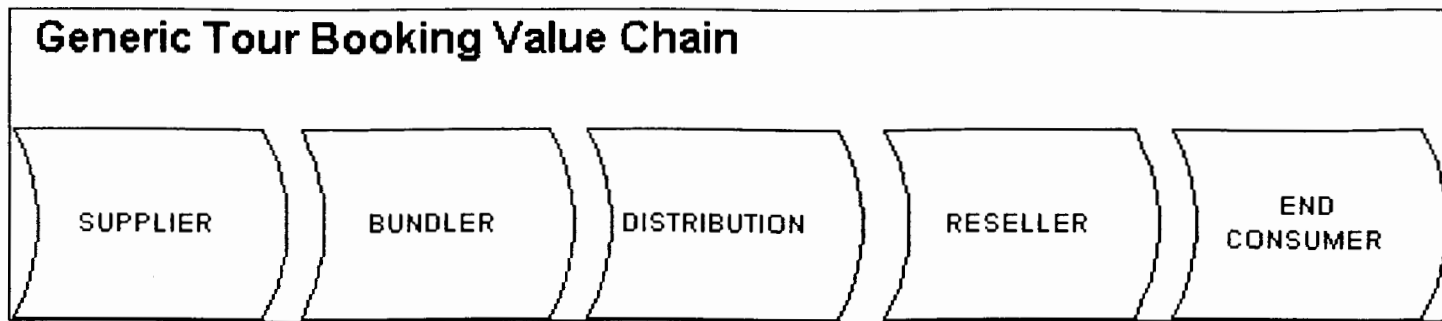


Figure 6: Generic Tour Booking Value Chain

*By author*

In summary, tour distribution refers to bookings made by tour operators or wholesalers who subsequently have their own channels of distribution, regardless of the number and types of components, but have as their commonality the end “leisure” consumer. The travel distributors for tours, such as GDSs, primarily target tour operators/wholesalers as their supplier customers, and the leisure agency as their end user. Tour operators commonly sell packaged vacations, and wholesalers commonly sell FIT travel.

#### **2.1.3.2.2 Tour Distribution Technology**

The level of automation available for a tour operator is below established needs in the current business environment. According to a survey<sup>30</sup> conducted by New York University and PhoCusWright, most operators are ready to upgrade their technology in the distribution channels. The most frequently requested products by tour operators in this survey were web-booking engines (or GDS bypasses), followed by GDS interfacing, and, finally, leisure travel solutions. Key objectives stated by the survey respondents included the ability to grow sales and lower transaction costs through their own websites and through online agencies.

The business-to-business interactions, such as GDS connections to tour companies, are evolving at a much slower rate than within other travel components. Tour operators already possess connectivity that works and is capitalized - migrating to new network technology such as TCP/IP is often costly. This is due to the fact that the companies would be required to operate two different networks during a migration. Considering all of the runtime and operational costs of each, the companies will not achieve real savings until all of their connections are moved to the new technology. The size of these investments will be a real constraint for many small operators

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<sup>30</sup> New York University and PhoCusWright Joint research (2003), “Building the online vacation package marketplace: survey results”, p. 9

and even for the mid sized players. Thus, the GDSs are in effect acting as barriers to enabling tour operators to distribute online.

Nevertheless, tour operators are attracted to the promise of lower distribution costs and the rich content that the Internet offers. In 1996, scientists at the Massachusetts Institute of Technology created ITA Software and launched a product called TAP. This was a universal protocol which is a server based technology, and can be situated on a legacy data system, allowing queries and presenting results back in either a desktop GUI application or browser-based format. In Canada, Accovia has the exclusive Canadian rights to use and sell this technology, but to date have not deployed this widely or effectively. (This may pose the following risk to the GDSs: if Accovia deployed TAP widely, they would have the ability to create a B2C booking portal which aggregates all of their current tour operator content on a shop and book website, without a GDS). Meanwhile, many tour operators have developed their own APIs (Application Protocol Interfaces) that allow them to retrieve inventory data and display it on their own website, bypassing the GDS. The challenges with this model are that not every development will enable the same type of functionality (a consumer may be able to shop and book on one site, but only shop on another), there is little interoperability, and there is very low marketing investment. Branding on the Internet is an expensive undertaking, and while an individual tour operator website does not benefit from the marketing reach of a GDS, it does represent the beginnings of a new online tour channel excluding the GDSs. However, a number of innovative approaches have emerged. For example, Conquest (a major Canadian Tour operator) built an API and allows Travelocity.ca access to it for free. In return, Conquest is able to distribute through Travelocity.ca and pay a small booking fee for doing so.

The GDSs are at risk of losing tour operator business if universal standards that facilitate low cost transactions via the Web become widely established. There are many technology providers that will soon enable new methods of online distribution subject to their technical abilities and adoption rates. According to a New York University and PhoCusWright survey<sup>31</sup> browser-based tools and increased access speed will change travel agents' relationships with the GDSs.

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<sup>31</sup> New York University and PhoCusWright Joint research (2003), "Building the online vacation package marketplace: survey results", p. 6



### **2.1.3.3 Tour Distribution - Canada**

#### **2.1.3.3.1 A Tour Operator Market**

Canada has a number of unique characteristics that affect travel distribution and especially tour. These include bilingualism, a small and dispersed market, a different airline history and, as a result, different consumer purchasing behaviours than the USA. There is a different composition and mix of airline companies and tour operators, as well as differences in the applicable regulations and subsequent transaction processing requirements.

There is an important distinction in the Canadian market with respect to ‘scheduled’ (domestic and internationally owned), budget (domestically owned), and charter carriers (domestically owned) airlines. The history and influence of the charter carriers has a direct and unique bearing on the tour business in Canada today, as compared with the USA. The federal government, via the Canadian Transportation Agency, regulates scheduled carriers and establishes the terms and conditions of carriage. Scheduled airlines are obliged to operate their flights in accordance with their regulated service schedule, and exceptions to these services are made only for safety reasons such as bad weather, mechanical problems, etc. Air Canada is the dominant carrier in Canada, and whereas the largest US airlines have a maximum of 15% of domestic market share Air Canada enjoys approximately 80% share of the domestic passenger lift, 38% of all international lift, and nearly 45% of all trans-border air traffic<sup>32</sup>. Table 14 in Appendix A shows the summary of passengers for origin and destination for Canada on Air Canada. In recent years, budget scheduled airlines such as Westjet, Canjet and Jetsgo, plus Tango by Air Canada, have become more prevalent in Canada. Air Canada has attempted to stay competitive with the budget (low cost) carriers by offering re-branded aircraft with low fares on a few key routes.

Currently, the regulations governing charter flights differ significantly from the regulations governing scheduled carriers. Charter operators can make changes such as days of operations and the destinations served due to the business considerations of the firm, unlike scheduled carriers. There are only a few true ‘charter airlines’ in Canada, the two largest being Air Transat and SkyService. Their markets are typically served with low frequencies (sometimes only one or two flights a week) and service highly seasonal leisure destinations in Europe and Mexico. Montreal-based Air Transat is Canada's second-largest airline in terms of revenues (\$801

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<sup>32</sup> Data compiled from Internal Sabre Holdings documents

million in 2001) and operates a fleet of 17 aircraft. SkyService is based in Mississauga, Ontario, and serves nine domestic points on behalf of Conquest Vacations. It has announced a plan to expand its fleet from 5 to 11 aircraft by the spring of 2003. The market has also experienced two recent entrants: Vancouver-based HMY Airways began charter service to Mexico, the UK, and two US cities with two aircraft in 2002; and Ottawa-based Zoom Airlines began service in conjunction with an operator named Go Travel Direct Vacations<sup>33</sup>.

Charter carriers do not sell their flights directly to the public, but rather sells the seats to Tour Operators or 'charterers' to resell. Therefore, the Tour Operator, rather than the carrier, establishes terms and conditions of carriage. Tour Operators may act on behalf of a charter airline, or make an arrangement with a carrier (even a scheduled one) to "charter" seats or even an entire aircraft, and may or may not assume the risk on the inventory. For example, Conquest (a tour operator) sells Las Vegas holidays through travel agents and direct to consumer by chartering a scheduled airline (a Westjet branded aircraft). Note that these operators are attractive to the travel agency channel because they offer commissions between 10 and 15% versus a non-commission paying scheduled airline that services the same destination. They are also attractive to consumers because the price for air plus hotel can be the same or less than air only on a scheduled carrier. An important point is that, unlike scheduled carriers in both countries, charter airlines are not obliged to participate in all of the GDS distribution networks equally. Also, unlike their US counterparts, tour operators in Canada may perform all of the defined functions of a tour operator, except that the sale may be for only one component – air – with a charter airline.

With respect to transaction processing requirements, Canada participates with the International Air Transport Association's (IATA) Billing & Settlement Plans (BSPs) which, like the Airlines Reporting Corporation (ARC) in the U.S.A., arrange for travel agents to be supplied with ticket stock, produce periodic billing statements and arrange collections from each Agent and then pass the necessary funds on to the Ticketing Airline. The different specifications for ARC vs. BSP have an affect, for example, on the type of ticket printer that can be used.

The success of the charter carriers/tour operators via 'charter' aircraft has caused growth in the all-inclusive package holiday market, more so than in the US. In the US, there are more domestic opportunities for holiday destinations, and there are few charters, so FIT travel is more common. The Tour travel business activity in Canada is primarily driven by the charter business servicing vacation destinations. There are charter domestic services between the largest cities in Canada, but the main product activity coincides with the top five international destinations for

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<sup>33</sup> Transport Canada Policy Group, (2003). [http://www.tc.gc.ca/pol/en/Report/anre2002/9C\\_e.htm](http://www.tc.gc.ca/pol/en/Report/anre2002/9C_e.htm), accessed: July 14, 2003

Canadians. These include the US, the UK, Mexico, France and Cuba <sup>34</sup>. The size of the market can be measured by the number of bookings and by the number of travellers - 2.5 million on packaged holidays in 2002, according to the Expedia Canada Corporation <sup>35</sup>. (Expedia Canada Corporation provide an online travel service, called 'Expedia.ca'). While it is difficult to correlate the number of travellers and the gross 'travel spend' with the market share of the tour operators, the charter airlines, and the channels of booking, it is the case that the tour operators are a central and controlling component of the tour distribution industry in Canada. Such data is not readily available, but would enable a more through examination of the leisure business in Canada.

### **2.1.3.3.2 Switch Technology**

The history of tour distribution is different than the history of air distribution and the rise of the GDSs, but the two events do parallel each other. In the 1980s, the Quebec government began funding software developers in that province who focussed their attention on the tour business. A firm called Logibro from Montreal sold licences and hardware, and managed the software to run the information needs of their client tour operators. The information needs of an operator include the housing of suppliers' data, sometimes inventory, transaction and reservation processes, and complex accounting systems that provide for net payments to suppliers as well as 'wholesale' rates to agencies and retail rates to consumers. The ability to package the information and make it available via the new GDS technology helped fuel the growth of a number of key operators. These operators began to enjoy a national reach as more travel agents adopted the GDS technology, and so the operators competed on their product range and service abilities. From the GDS point of view, third party providers were able to offer tour operators and charter airlines functionality that neither the GDS nor the tour operator could develop for themselves.

In Canada, there are now two firms that compete for this tour operator business. They are called switches, as their primary role in the tour booking process is to act as a switch mechanism. Logibro was one of the first firms in this arena, has recently changed its name to Accovia and uses Logibro patented technology. The other is a firm called SoftVoy@ge that uses Levy patented technology. Both firms are a legacy host text-based emulation inventory management application that can interact with multiple GDSs. The switches are able to offer the tour operators IT functionality such as reservation management, and offer charter airlines transaction processing.

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<sup>34</sup> Euromonitor (2003) "Travel and Tourism in Canada", p. 31

<sup>35</sup> WebTravelNews.com (2003). "Expedia adds online vacation booking with Logibro", Interview with Stuart McDonald, Managing director Expedia Canada, accessed: June 17, 2003.

(The switches are attempting to host live charter inventory on behalf of the carriers as an extension of their business). The switches have by now 'locked in' their tour operator customers, so that either a travel agency or a consumer direct booking will have their reservation process handled by the switch. The contracts between the tour operators and the switches are for providing maintenance, licensing, and upgrades (that tour operators pay for), in exchange for fees for bookings. They were based on an initial 3-year term, and are automatically renewable every year. Each switch is attractive to a different kind of tour operator: Most FIT tour operators find SoftVoy@ge a better fit, whereas the packaged tour operators, find Accovia better meets their needs. Much of the tour operators marketing efforts are aimed at the travel agent level, so educating them on which switch to choose is an important part of their strategy. These systems are cumbersome to the users, are not easily interoperable among other emulation based software applications, and cannot provide web services type of rich content and features that consumers and or travel agencies are increasingly looking for. For example, Logibro actually ghosts the inventory from a supplier, and refreshes content a number of times a day. An agent needs to enter text on a number of sequential screens in order to determine the price of a package and its availability. If Tour operator A does not have the product, the agent must back out of that screen, and re-enter the information along the screens for Tour operator B, and so on.

Sabre Holdings took a 10% ownerships position in Accovia in 2000. The intention was that Accovia would, with guidance from a STN Leisure department representative from Dallas, develop a shopping application for Sabre Canada agencies. To date this has not happened, nor have any significant milestones been achieved. Accovia's 'switch' competitor, SoftVoy@ge has begun developing shopping applications for operators that bypass the GDS. To date, Accovia have not become such a competitor. While Accovia is not a competitor to Sabre, it has not yet delivered on the promise, so Sabres' position with respect to this function has not been advanced either.

Thus, Sabre and Galileo have had agreements with the switches to provide content and reservation management to the GDS channel for many years. The GDSs have also built interface procedures so that an agent can merge the reservation back into Sabre, for agency accounting and productivity requirements. The GDS actively attract this business (versus consumer direct) by incentivizing the agency with extra productivity credits per 'tour booking'.

### **2.1.3.3.3 New Technology firms**

In Canada there are several concurrent new developments with respect to tour distribution, and several firms actively engaged in delivering new solutions. See section 2.1.5 for a review of the main players, and table 16 in Appendix A for their products. These firms have not had a significant impact on tour distribution in Canada yet.

### **2.1.3.3.4 The players in Canada**

Tour Operators generally have very low margins, and are looking for more cost effective ways of managing their inventory and distribution. The fluctuations in demand have driven some vertical integration among the domestically owned tour operators, and brought some overseas investments into Canada. September 11, 2001 caused an immediate and drastic reduction of demand for tour products so that several operators went out of business, merged or consolidated. For example, Canada 3000, its tour operator Canada 3000 Holidays, its subsidiaries Royal Air and CanJet plus others such as Viva Holidays, and Enterprise Holidays went bankrupt. There has also been merger and consolidation activity: Regent Holidays merged with World of Vacations, which was sold to Transat A.T. Inc. There are a small number of dominant tour operators in Canada. It is difficult to gather data to describe the size and market share of these players, however this project will use Sabre's market share of GDS tour bookings as a proxy for the market size. This is based upon three parameters:

- a) Sabre has nearly 60% share at the point of sale (travel agency desktop),
- b) Canadians use travel agencies for 80% of their packaged vacation purchases, and
- c) Agencies use a GDS for about 80% of these bookings.

The biggest operators are the Air Transat Holidays (ATH), Conquest, Signature, and World of Vacations (WOV), see figure 7, below. The Transat A.T. Inc is the largest and most vertically integrated of the Canadian Tour Operators. They are publicly traded company on the TSE (TRZ), with 2002 revenues (year-end October) of \$2.2B CDN with \$7.7M CDN net income. (The company lost money in 2001 despite higher gross revenue). The company owns a charter airline, Air Transat, a number of tour operators such as ATH, WOVI, an FIT operator Americanada, and a Quebec based retail chain, Consultour. Similarly, the 'Mytravel' Group PLC from the UK (where they own various transportation and travel related firms) has been acquiring tour operators in Canada (Alba and Sunquest) and buying retail agencies, such as the Ontario

based Algonquin chain and independents such as Belair Travel. Air Canada Vacations is unique because it only charters (scheduled) aircraft from its parent company, Air Canada.

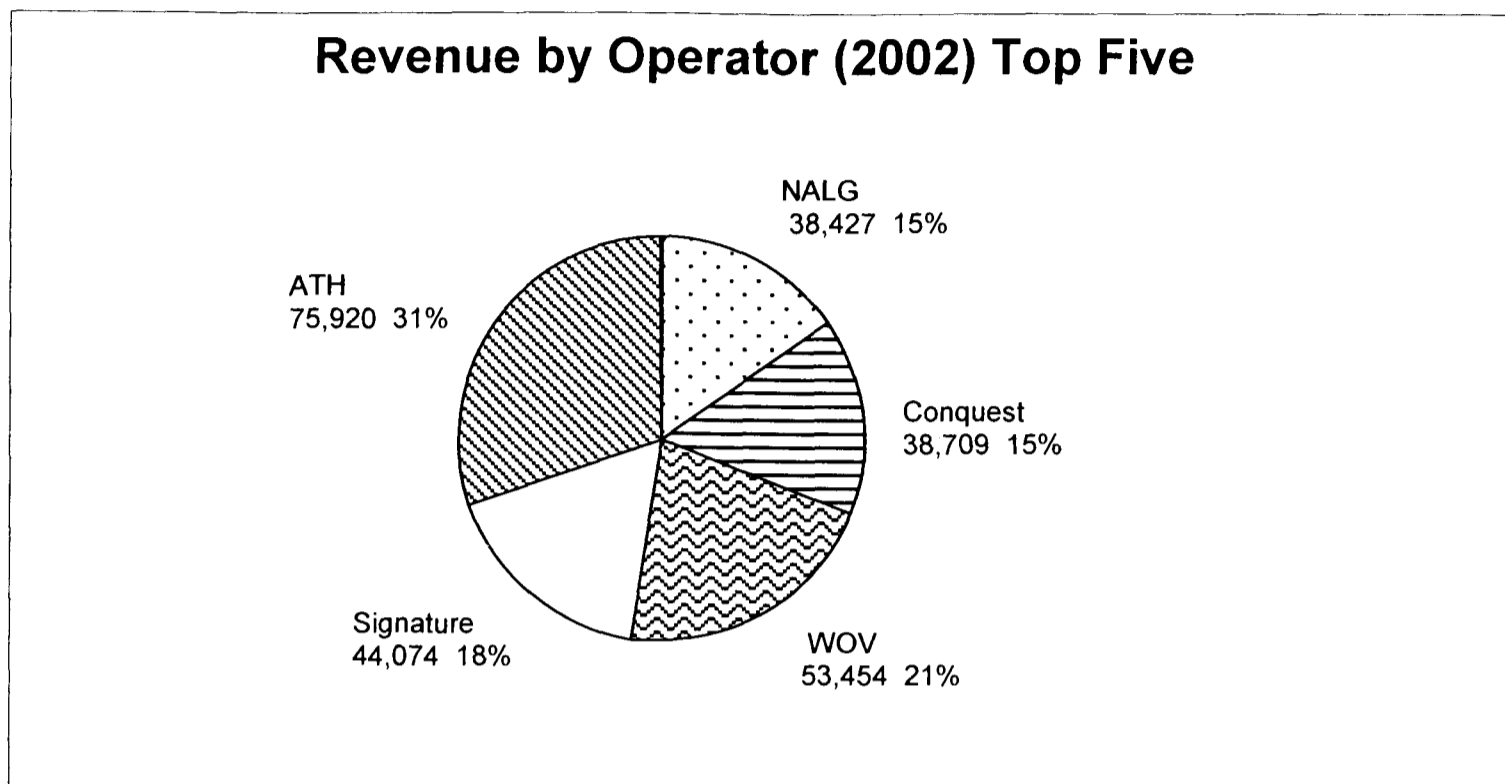


Figure 7: Number of GDS bookings by Canadian Tour Operator, Top 5 in 2002.

*Figure by author; data compiled from Sabre Holdings 2002 tour operator productivity report, 2003*

#### **2.1.3.3.5 Tour Distribution - Market Structure and Business Model**

The market structure for tour distribution is influenced by a number of factors. These are economic forces that may influence the amount and type of inventory the suppliers will provide, the amount of demand from the (fragmented) agency and consumer channels, adverse climatic or political events, the nature of competitive rivalry, and the differences between the two markets. In the absence of informational standards there has not been a rush for informational scale as there was for air distribution and the CRSs. However, the key to understanding the market in Canada is that the tour operators and the switches are in positions of significant influence, if not market power. Mitigating that influence to a certain extent is that all of the intermediaries (airlines, operators, GDS, and agencies) are in a partly cooperative and partly competitive environment. That is the relationships are not always arms length, and there is co-dependency between players. Brandenburger and Nalebuff from Harvard Business School and Yale School of

management coined the term co-opetition<sup>36</sup> to describe a partly competitive and partly cooperative state of affairs.

<b>Owner</b>	<b>Airline</b>	<b>Operator</b>	<b>Retailer</b>	<b>Technology</b>
<b>Transat Group</b>	Air Transat	ATH Nolitours World of Vacations	Consultour	None
<b>First Choice UK</b>	None	Signature	Amex Leisure, Sun Holidays, Encore Cruises, Sunflight Vacations, and others	None
<b>MyTravel (Airtours in the UK)</b>	None	NALG, Alba, Holiday Network, Tourmaison, Sunquest Canada and US, Vacation Express Atlanta	MyTravel Outlets are becoming branded as MyTravel, but other current brands are Last Minute Club, Discount Travel Warehouse, and others	Developing
<b>Private; 49% Owned by Marktravel (US)</b>	None	Conquest, Conquest International	None	API to Travelocity developing

Table 2: Canadian Players

*Figure by author; data compiled from Sabre Holdings 2002 tour operator productivity report, 2003*

Consider that airlines (scheduled or charter), hotels, land operators, etc provide the operators with certain amounts of inventory for bundling, at discounted rates. They will do so subject to their relationships with operators (one airline may choose to provide similar content to a small number of operators for example), current and forecasted business conditions, and these volumes change year over year. The destinations an operator can offer will be affected by political and weather related events - Cuba has seen growth in visitor numbers from Canada whereas US citizens are not able to travel there, for example. The effect has been to create a

<sup>36</sup> Brandenburg & Nalebuff (1996). "Co-opetition: a revolutionary Mindset That Combines Competition and Cooperation: The Game Theory Strategy That's Changing the Game of Business"

fragmented market of often regionally based, highly competitive tour operators, with low operating margins. There are many operators ranging in size from Mark Travel in the US that handled 3 million passengers in 2001 <sup>37</sup>, to the very small Mom and Pop operators at destinations, who hope to attract bookings other than ‘walk-ups’. In the US, PhoCusWright estimate the value of this business at \$17B in 2001, and expected it to grow to \$22B by 2004 <sup>38</sup>.

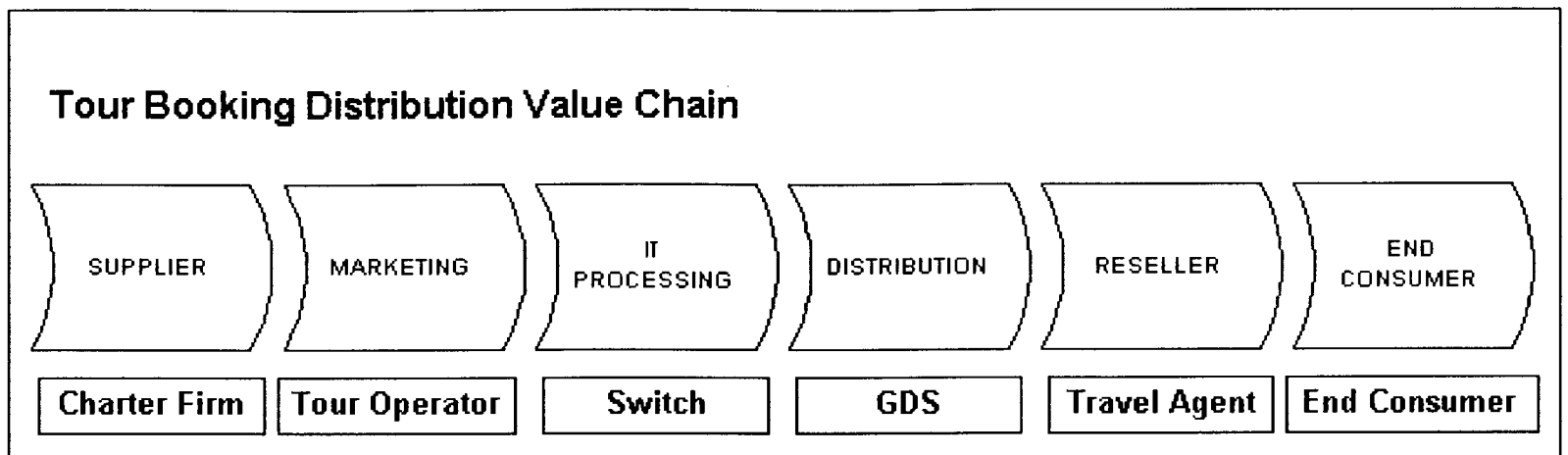


Figure 8: Tour Booking Value Chain - Canada

*By author*

The industry is funded partly by consumer demand, partly by the distribution fees, and partly by the fees between the suppliers and the operators. In Canada for example, a charter airline may pay a tour operator a fee for marketing their product as well as commissions per booking. So the business model is dependant upon suppliers’ willingness to participate in a reseller market, consumer’s willingness to pay, and agency comfort with the available automation. Note that in Canada, for charter airlines their willingness to participate is a forgone conclusion: they are obliged to distribute via the tour operators. The operators package the supplier components and set prices by including distribution and marketing costs in their mark ups for retailers, that is, they have traditionally used a cost plus model for pricing the travel product. That is, the market does not freely establish the prices, the operators’ mark ups do. Any unsold inventory usually falls back to the suppliers, or will be sold off at distressed prices at the last minute. The operator will pay a commission to the agency making the sale, and if that booking is transacted over the GDS, the operator will also pay a GDS booking fee. In Canada the GDS booking fee may contain a revenue share agreement with the switch, see section 3.1.9. The

<sup>37</sup> PhoCusWright Inc., (2002). “Selling Vacations: The Online/Offline Challenge”, p. 7

<sup>38</sup> PhoCusWright Inc., (2002). “Selling Vacations: The Online/Offline Challenge”, p. 6



uptake of automation is high in Canada but low in the US. Consider that travel agencies account for 87% of all tour bookings made in the US, driven partly because consumers still prefer to make large purchases this way. However, of that 87%, fully 86% of these reservations were made by a phone call to an operator. In Canada, consumers used travel agencies for about 75% of all tour bookings (anecdotal evidence from Sabre tours), but of these about 80% were made electronically. That is, Canada is a smaller and more automated market for tour distribution. There are fewer tour operators and the information standards are therefore less diverse and complex. The agency channel represents an expensive option to an operator, because there are commission costs (between 10-15% per gross sale), and automation costs for the GDS. In Canada there are also costs for the switches, and in the US with less use of automation, there are substantial costs for running an agency/consumer call centre. That is, transaction costs vary dramatically depending on the channel of booking. For example, a travel agency automated booking can cost about \$10 versus about \$35 for a direct telephone sale, see section 2.1.4.3.1.3.

## **2.1.4 The Forces affecting Distribution**

### **2.1.4.1 Introduction**

The distribution industry as defined, has as its largest constituent the large US network carriers and the business travellers they carry, predominantly for domestic travel in the US. Any changes in the environment that impact here have profound affects throughout the industry. The leisure or tour travel business is a subset of the travel industry, and its distribution market has similar characteristics, so is described accordingly.

The primary external forces are inter-related, often have dynamic technologies as their root cause, and are having a dramatic affect on the North American travel distribution industry. These are:

1. Fluctuations in demand,
2. Changing consumer behaviour
3. New entrants
4. Emerging business models and technologies

The impacts of the forces in the industry are changing key industry characteristics. For example, the impacts are driving changes in the size of the component markets, the behaviour

within the consumer segments and component suppliers, as well as changes in the types, sizes and costs of the channels of distribution.

#### **2.1.4.2 Fluctuations In Demand**

The 1990s saw travel demand increase steadily year over year, and then change abruptly early in the new century. The Travel Industry Association of America 2002 report states that US domestic travel volume by 2001 had increased by 8% over 1994, while US population growth was 9% over the same period. Leisure travel volume (broadly defined as any travel not business related) increased at a faster rate to reach 13% higher in 2001 than 1994. However, worldwide passenger air traffic year to date in 2003 was 3% lower than in 2002<sup>39</sup> representing 2.5 million seats, which has had a drastic effect on the ability for the major US full service scheduled airlines to make a profit. In 2002, the global total travel spend for the distribution industry was USD \$741B, of which nearly 40%, or roughly USD \$240B is attributed to the North American consumer. Figure 26 in Appendix A shows current spend travel component (per supplier type), channel, and consumer. Figure 27 shows the forecast for 2006, for the same parameters. The future is more promising: demand for travel is forecasted to grow between 2003 and 2006 at a 3.1% annual growth rate<sup>40</sup>; leisure travel will be faster at 4%, though much of this via the online channel. In order to understand the impact that fluctuations in the type and amount of demand is having on the industry, a review of the current market characteristics is required.

##### **2.1.4.2.1 Impact on GDSs**

The biggest impacts that such fluctuations in demand are having on the GDSs are that suppliers are concerned with two primary aspects: cost containment and control of the end traveller. The largest airlines that fund the biggest distribution channel (GDS/agency) are applying pressure to the GDSs to reduce their fees, so lowering their overall distribution costs. One way of doing this has been for the carriers to build their own websites for distribution and provide consumer incentives, in the form of low fares, to visit their sites (this is known as “GDS bypass”). There is some evidence that the effect to the airlines has been to decrease their yields on

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<sup>39</sup> OAG Quarterly Report on global airline schedules, [http://www.oag.com/about\\_oag/company\\_info/press\\_releases/us/qtlyreportJune.asp](http://www.oag.com/about_oag/company_info/press_releases/us/qtlyreportJune.asp), accessed: June 27, 2003

<sup>40</sup> CIBC World Markets Equity Research (June 2003), “Company Update – Sabre Holdings Corporation” p. 2

certain routes, they are substituting their high yield passengers from the GDS/agency channel to low yield passengers on the online channel. Air Canada and Continental have also introduced commission incentives aimed at agencies that make bookings via an agency only portal. Despite concerns about diluting yield, there have been some notable successes. Five of the largest US carriers have formed an online website portal called Orbitz, which has quickly become that country's 2<sup>nd</sup> largest travel agency. So, while the carrier's position cost containment as the primary driver of behaviour, it is likely that the cost of building, maintaining, improving, and incentivizing online consumer purchases will cost them more money in the short term. The issue therefore is likely to be one of controlling the channels of distribution and ultimately the end traveller, and the most cost effective way of distributing product. This phenomenon is also called channel shift see section 2.1.4.3.1.

#### **2.1.4.2.2 Impact on Components**

The market size for the travel distribution market is described according to the gross US dollar value in terms of travel spend, (\$240B USD in 2002), and segmented by the travel component type, the type of consumer and channel of distribution. The components of travel are air, car, hotel, tour, and cruise bookings. While these may seem self explanatory, the tour or leisure booking is of interest to this project, and requires a more detailed discussion because of the many names commonly used to describe the same thing, see section 2.1.3.2.1.

World demand for air travel is lower in 2003 than for the year 2000 and the effect on the largest US airlines has been disastrous – several (such as United Airlines) are in Chapter 11 protection at the time of this project. Figure 9 graphically represents the number of enplanements for domestic and international flights in the US between August 2001 and Jun 2002. However, the changing demand for travel has also provided stimulus for the low cost, low fare, no frills carriers, such as SouthWest, AirTran, JetBlue in the US who have enjoyed increasing profitability when compared to their large rivals.

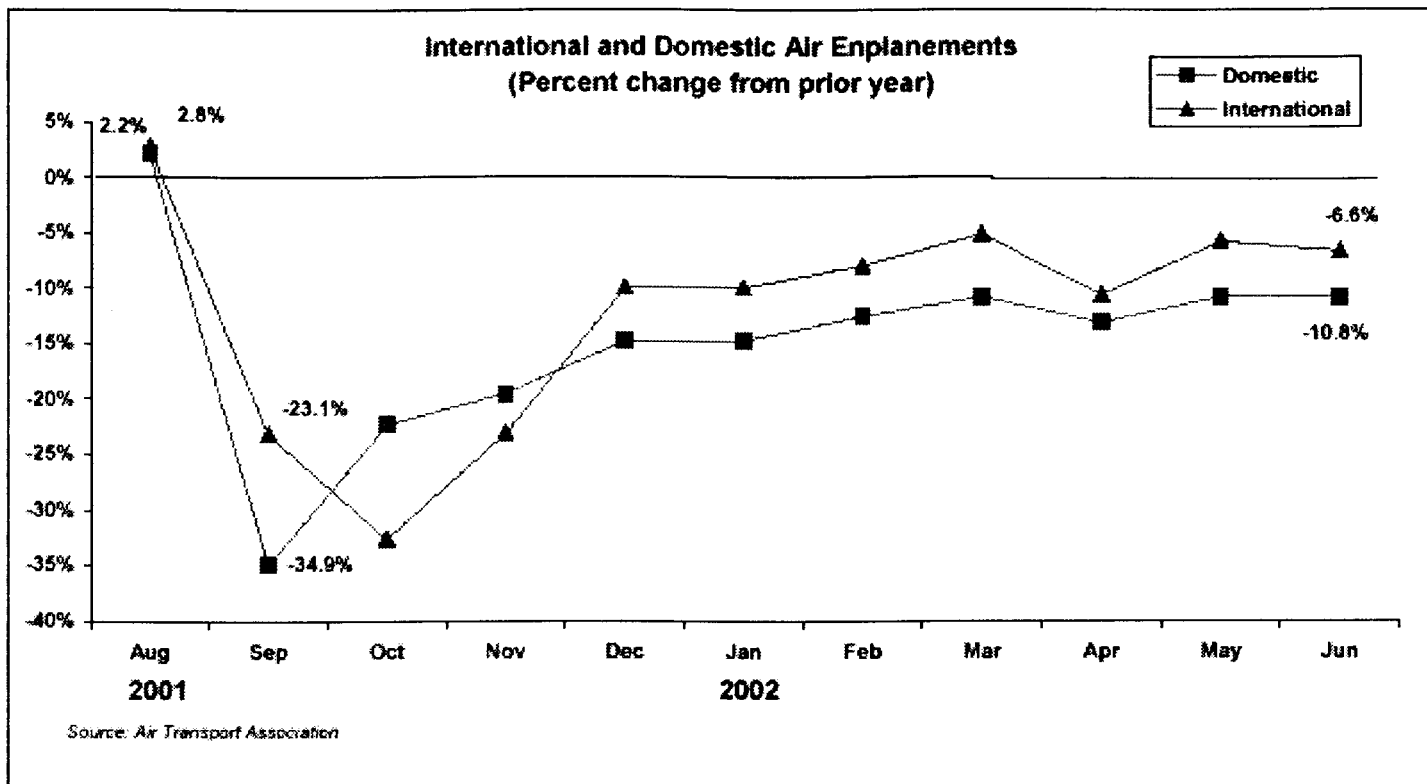


Figure 9: International and Domestic Air Enplanements (US figures)

Source: Used by permission of the Travel Industry Association of America

By 2003, the low costs carriers in the USA account for 24% of all domestic passengers in the US, or over 100 million passengers<sup>41</sup>. Figure 10 shows the operating income for the large US network carriers (full service) versus the low cost US carriers for domestic traffic. The full service carriers dipped into the red in the early 90s, became profitable during the mid 90s, but they are now deeply indebted. The low cost carriers however, have grown in profitability during the 90s, and while their profits have been curtailed since 2000, they are still in the black. These low costs carriers either do not participate in, or have reduced participation in, the GDS channel, representing a direct threat to GDS revenue.

In Canada, the air travel sector experienced strong growth between 1997 and 1999, but the merger of Air Canada and Canadian Airlines impacted air travels' share of the transportation market. The amount of domestic capacity went from a forecasted increase of 8% to a realised 0% growth, in 2001<sup>42</sup>.

<sup>41</sup> Data compiled from internal Sabre Holdings documents

<sup>42</sup> Euromonitor (2003) "Travel and Tourism in Canada", p. 52

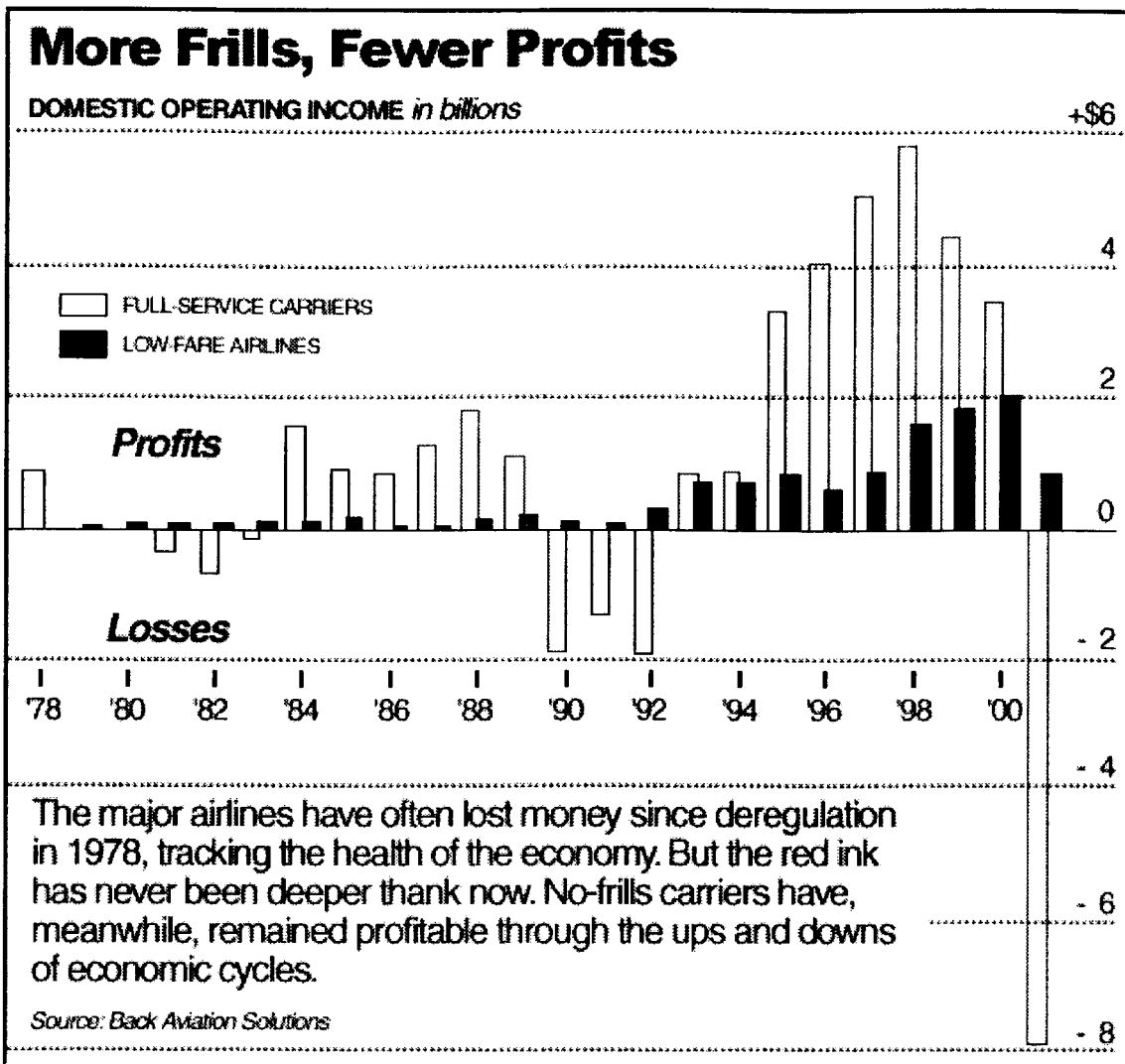


Figure 10: Fluctuating Demands and the Rise of U.S. Low Cost Carriers

Source : Used by permission of Back Aviation Solutions

The knock on effect of changes in air demand has been to depress demand for some complementary travel components such as car rentals (~ -10% between 2002 and 2000), and hotel space (~ -2.3% decline on revenue per available room between 2002-2000).

The weakening demand for air travel by scheduled carriers has dampened demand for tour travel, but not to the same extent. Figure 11 shows the year over year percent change in US business and leisure travel as measured by person trip volume broken out by month, between 2000 and 2001. Leisure travel has not suffered the same reduction in demand as business travel has. The total leisure spend in the US dropped from \$133.7B USD in 2001 to \$127B USD in 2002, but is forecasted to grow steadily to \$156B by 2007<sup>43</sup>.

<sup>43</sup> Data compiled from internal Sabre Holdings documents

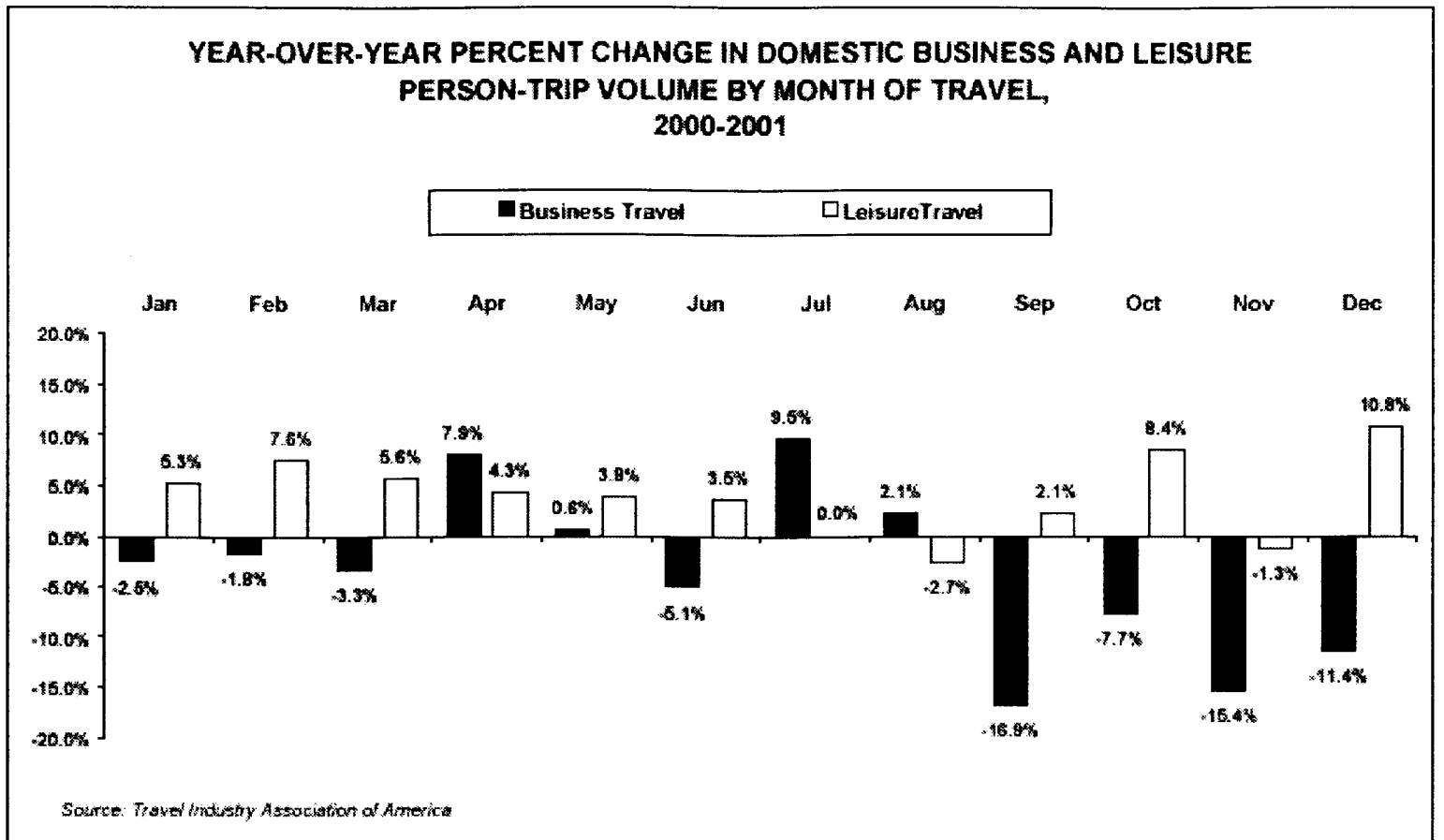


Figure 11: Year over year percent change in US domestic business and leisure person trip By volume of month of travel, 2000-2001

Source – Used by permission of the Travel Industry Association of America

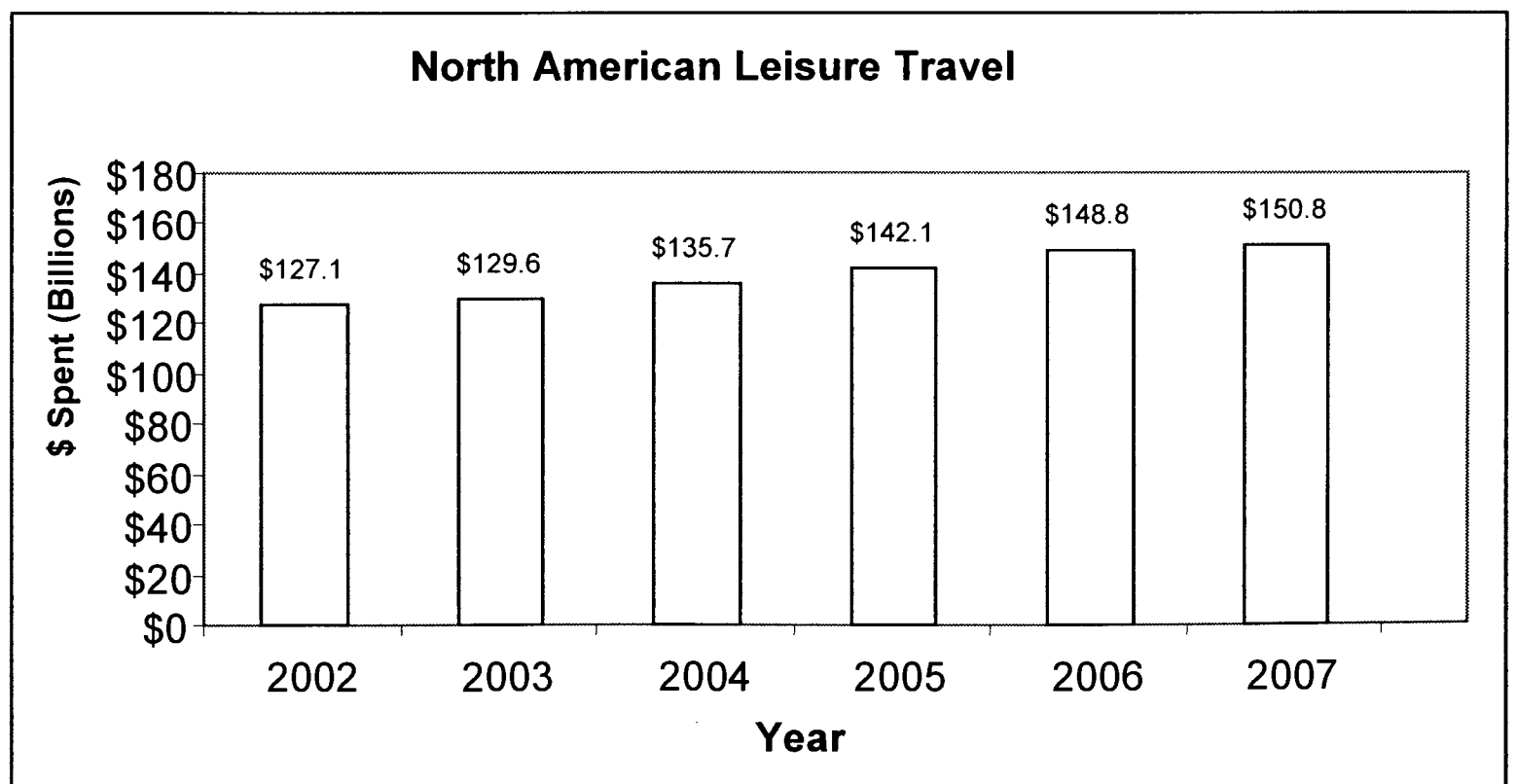


Figure 12: Trending forecast

Figure by author; data compiled from Sabre Holdings report 2002

Source – Sabre Holdings.

While the market size for tour travel is difficult to quantify, the USTOA estimate that between 2001 and 2002 the number of trips by Americans was up 3%, though the average spend was down from \$2200 USD per trip to \$1830 USD per trip<sup>44</sup>. Note these numbers may be skewed by the USTOA methodology - leisure is defined here in the tourism context, rather than the distribution context. This means the number of people reporting leisure activities, rather than the number of leisure travel products sold may inflate these numbers.

There are few data sources for Canadian figures; anecdotally the US usually has 10x the amount of activity, though tour is a more significant component to the travel mix in Canada than in the US. See Figure 24 for a description of the percentage of bookings that tour makes up in Canada versus the US. Otherwise, this project will consider forecasts and trends as comparable for both countries. This means that tour or leisure travel in Canada has probably not declined as much as business travel since 2000.

#### **2.1.4.2.3 Impact on Consumer Segments**

There are three types of end user: leisure, unmanaged business traveler, and managed business traveller. A leisure traveller is motivated primarily by vacation needs or by visiting friends and family (VFR). A managed traveller is one who is travelling on behalf of a firm that has corporate travel policies in place, such as which airlines to fly, or which days they must be active, etc. This is the domain of the corporate travel agency, who is able to monitor corporate policies, build relationships with travellers, and provide revenue sharing opportunities with the end corporation. The leisure travellers segment is sought after especially by non corporate travel agencies as the latter can provide a range of options and earn better commissions from tour operators by selling packages. The majority of 'leisure bookings' come from this consumer segment. An unmanaged business traveller is typically drawn from small businesses where travel is less frequent than the managed traveller, and the firm's needs are less onerous, if any, beyond costs and timing. This segment has traditionally been a 'shopper' of travel agencies, as they go looking for the best fares and service, similar to the leisure traveller. These latter two consumer segments are also the most likely to do their shopping online, and the online agencies are now actively building products to attract these segments away from the agency channel. Most leisure

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<sup>44</sup> Data compiled from internal Sabre Holdings documents

or tour bookings are attributed to the leisure traveller. “Leisure and unmanaged business” travel accounts for 76% of the total travel spend in the US <sup>45</sup>.

### 2.1.4.3 Changing Consumer Behaviour

According to the PhoCusWright 2002 Consumer Travel Trends survey <sup>46</sup>, growing consumer confidence on the Internet as a viable channel has led to a diversification of travel products available. Fragmentation continues in that on and offline channels are used simultaneously for research and purchase. The PhoCusWright survey also points out that the online travel agencies marketing efforts has translated to air purchase loyalty. While online travellers will use both online agencies and airline websites, the agencies are the single most often used type of site - they captured 66% share in this measure<sup>47</sup>. Figures 13 and 14 show the top web sites for air travel, and the sites used most often respectively. Sabre Holdings’ Travelocity, is ranked number one, with Expedia and Orbitz following as number 2 and three.

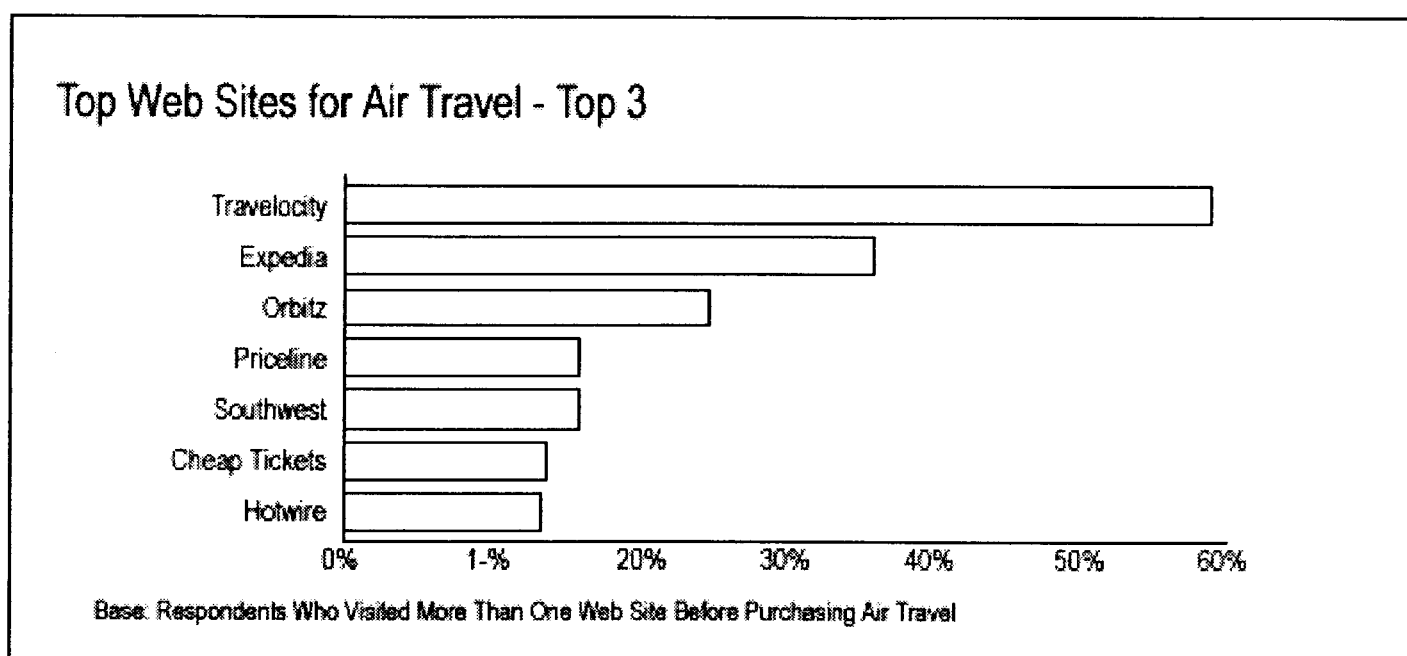


Figure 13: Top Web Sites for Air Travel, Top 3

Source – Used by permission of PhoCusWright: Consumer Travel trends Survey, Fifth Edition

<sup>45</sup> Travel Industry Association (2002) “Domestic Travel Report” Washington DC.

<sup>46</sup> PhoCusWright Inc (2003). “Consumer Travel Trends Survey, Fifth Edition”, p. 7

<sup>47</sup> PhoCusWright Inc (2003). “Consumer Travel Trends Survey, Fifth Edition”, p. 20



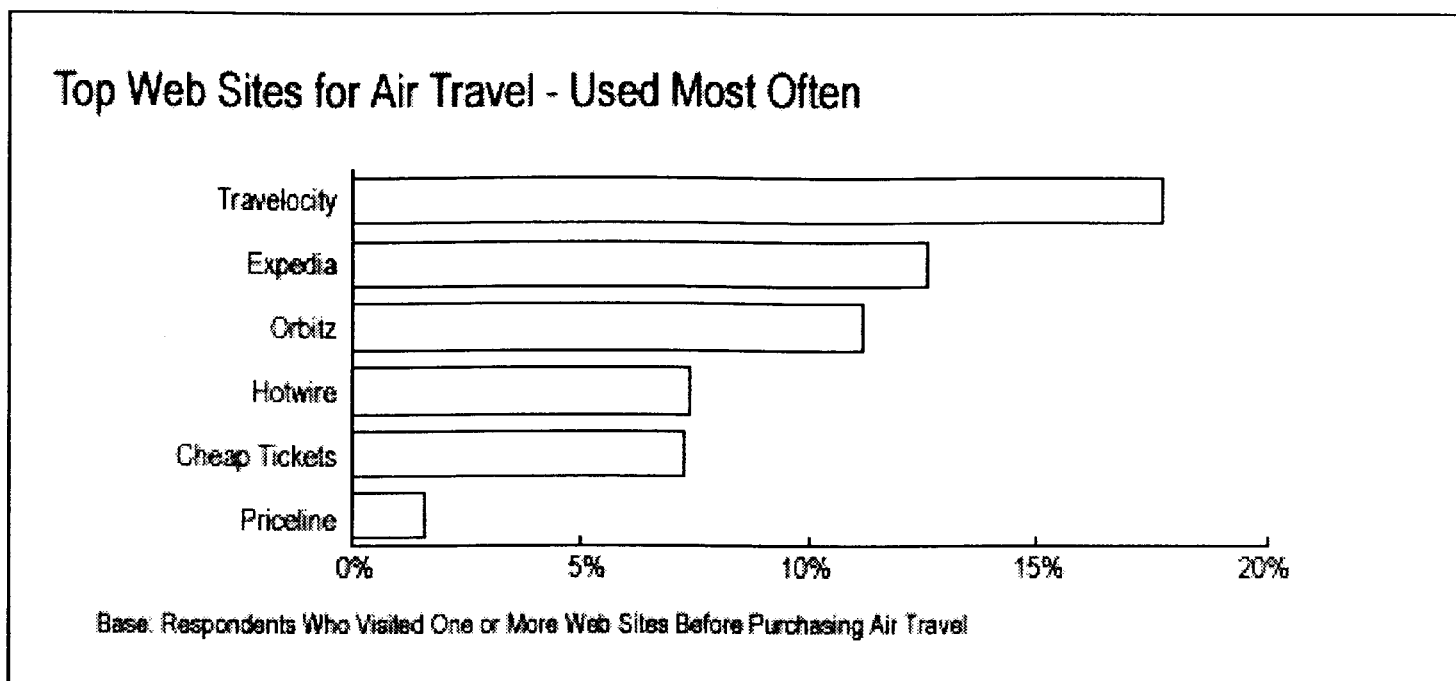


Figure 14: Top Web Sites for Air Travel, Used Most Often

Source – Used by permission of PhoCusWright: Consumer Travel trends Survey, Fifth Edition

There is a risk of airlines (especially) diluting their yield by distributing through these channels. Consider that two in ten purchasers of travel online are “web mercenaries”, according to Wholeview™ Technographics Research<sup>48</sup>. That is, the potential consumers regard price as the most important reason for purchasing on the web. Further, according to the PhoCusWright 2002 Consumer Travel Trends survey, 54% of online travellers say that price is the most important factor, followed by service and easiest to use. The number of websites shopped before purchasing air travel is 3.2 on average for example<sup>49</sup>. This poses a risk to suppliers, especially airlines, of diluting their yield by distributing through these channels.

As online consumer demand is fuelling growth, so the online agencies and suppliers are competing for positions in all channels. Orbitz received US DOT approval in 2003, and announced ‘Orbitz for business’, to compete with Expedia Corporate Travel. These sites will attempt to attract the unmanaged business traveller, and Sabre’s Travelocity has followed suit with an announcement of a new line of products called ‘Travelocity Business’. Expedia has plans for a site for travel agents to be released in 2003.

<sup>48</sup> Wholeview™ Technographics Research (2003). “Brands don’t matter to Web’s mercenary Travellers”

<sup>49</sup> PhoCusWright Inc (2003). “Consumer Travel Trends Survey, Fifth Edition”, p. 13

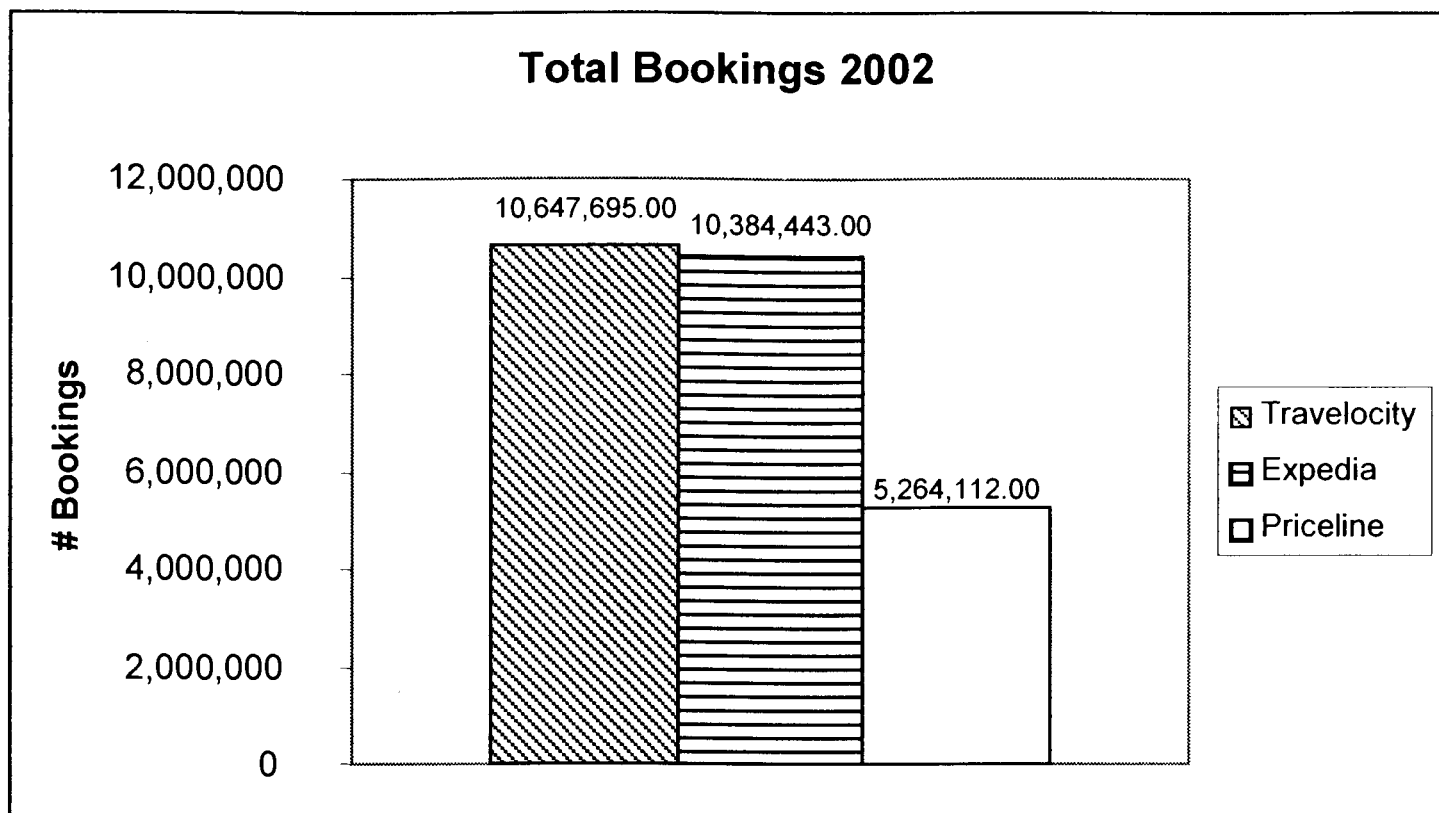


Figure 15: Total Online Bookings 2002

*By author*

#### 2.1.4.3.1 Impact on the Channels – the threat of GDS bypass

As seen on the traditional supply chain in Figure 4, for many years the distribution business has been a primary GDS channel acting as an oligopoly, plus an ancillary supplier direct to consumer channel. The rise of Internet technologies and accompanying changes in consumer behaviour has enabled the online channel. This is composed of suppliers who form their own online direct to consumer channel, and provided travel agencies with the ability for another interface for their end consumers – the agency website, and spawned online pure play agencies, such as Travelocity and Expedia. The effect has been to increase the number of channels options from two, to five.

These are:

1. Indirect Offline. This is the travel agency channel, also called brick and mortar, and regardless of interface – e.g. phone, agency website, or an in person visit. The reservation will be made on a GDS, which offer the full range of competing travel products.
2. Direct Offline. This may be an airline call centre or a consumer calling a tour operator, hotel, or car rental firm directly. The reservation will be made directly onto the supplier firms' proprietary database. Typically, the range of products offered is restricted to that supplier, though complementary products may be bookable.
3. Indirect Online. These are the online agencies such as Travelocity and Expedia. The reservation is made via the Internet and the data flows from the supplier inventory, often 'live' to the website. Online sites are able to offer a variety of competing travel products.
4. Direct Online. This channel is made up of suppliers' own websites with bookable content, such as AirCanada.ca, Orbitz.com, Hyatt.com. A reservation is made on the Internet and the data flows directly from the suppliers inventory database, 'live' to the site. Direct Online is increasingly able to offer complementary products.
5. Direct Corporate-booking tool Online. These are booking tools inside a corporation (on the desktop) that allow managed travellers to make reservations via the Internet directly to the supplier's inventory. Consider a firm that travels on United Airlines for its business needs, and the ability to book corporate rates and comply with corporate policies are available via the traveller's desktop. Note that Sabre, Galileo, Amadeus and some of the online agencies are competing with their own versions of these tools.

CHANNEL	SUPPLIERS		DISTRIBUTORS	TRAVEL AGENCY	TRAVEL AGENTS	INTER-FACE	END CONSUMER
Indirect Offline Channel	Airlines 1-n	ATPCO	GDS 1-4	Travel Agent 1-n	Desktop GDS 1-4	Phone Visit Website	Travellers
Direct Offline Channel	Airline 1-n		Self		No	Phone	Travellers
Indirect Online	Airline 1-n		GDS 1-4* and Online Agencies		Yes, for fulfillment	Website Call Centre	Travellers
Direct Online	Airline 1-n		Self-Own Website		No	Website Call Centre	Travellers
Direct CBT Online	Airline 1-n		Alliance		Yes/No	Desktop	Travellers

Table 3: The non-tour distribution channels

\* Booking engine only

*By author*

The amount of supplier distribution per channel has shifted in the last three years, and is forecast to continue to shift, see table 4.

Channel	Example	1999	2002	2006
Indirect Offline	Travel agency/GDS	61%	46%	DOWN
Direct Offline	Airline call centre	34%	28%	DOWN
Indirect Online	Online agency (Travelocity)	3%	12%	UP
Direct Online	An Airline website	2-3%	12%	UP
Direct CBT	A Corporate tool with a booking engine	Negligible	2%	UP

Table 4: Channel Forecasts<sup>50</sup>

Source – Sabre Holdings -copyright

<sup>50</sup> This forecast is based upon Sabre Holdings' scenario planning where 'portal power' is assumed to continue to be the likely outcome.

The rate of shift is accelerating: the indirect offline channel (travel agencies) is expected to lose 10.5% of leisure and unmanaged business travel between 2001 and 2004<sup>51</sup>. The online channel (agencies, corporate travel services, and supplier direct) has experienced strong growth but there is recent evidence that suggests the growth of online travel purchases may have peaked. A recent Jupiter research report says that the number of online travel buyers will remain flat at 28% between 2003 and 2007<sup>52</sup>. Similarly, a survey by PhoCusWright, quoted in a travel trade magazine, *The Travel Weekly*<sup>53</sup>, shows that not only have the number of travellers in the US with Internet access remained static since 2000, but that the number of adults who purchased travel online is slowing. The rate of uptake has changed from 83% in 1999 to 29% in 2001, and only 11% in 2002.

Interestingly, there is also evidence that between 17% and 21% of previous Internet users who have booked travel online, now prefer to use travel agencies<sup>54</sup>. The overall impact however is that the GDS oligopoly is challenged and the threat of GDS bypass is very real, even if the GDSs are playing in the online space. The majority of revenues supporting the GDSs are from suppliers selling into the agency channel, and the new channels represent a risk. Online portals such as Orbitz and Expedia are a new force in the distribution industry.

#### ***2.1.4.3.1.1 Costs per channel***

Part of the reason for the shift is the changing economics of distribution, though there is not yet a well-established advantage for any one channel. After fuel, labour and credit card charges the cost of distribution is the next largest expense for most large airlines. Distribution cost is estimated anywhere between 2-10% per ticket for a network carrier in the US<sup>55</sup>. According to CIBC the net GDS segment booking fee after all considerations are factored in, is \$3.94 for the travel agency channel, a third party online agency (such as Expedia) fee is \$3.84, and the fee applied by Orbitz (the airline owned portal), is \$4.40. There are several key assumptions in place to make this comparison, such as a difference in fare type and size per channel, and that traditional agencies sell tickets with fewer segments. If these figures are

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<sup>51</sup> Data compiled from Internal Sabre Holdings documents

<sup>52</sup> Jupiter Research (2002) "The 2002 US Travel Market Forecast, Market opportunity Assessment report".

<sup>53</sup> Northstar Travel Media, Art Pfenning May 26<sup>th</sup>

<sup>54</sup> Data compiled from internal Sabre Holdings documents

<sup>55</sup> Data compiled from internal Sabre Holdings document and CIBC World Markets Equity Research (June 2003), "Industry Update – GDS regulations: reviewing what's important", p. 9

accurate then the advantage currently lies with the indirect online channel, i.e., the third party online players, excluding Orbitz. The airline owners of Orbitz may not be able to compete with other online agencies based on price, but may use their collective brand equity to capture ownership of the end travellers.

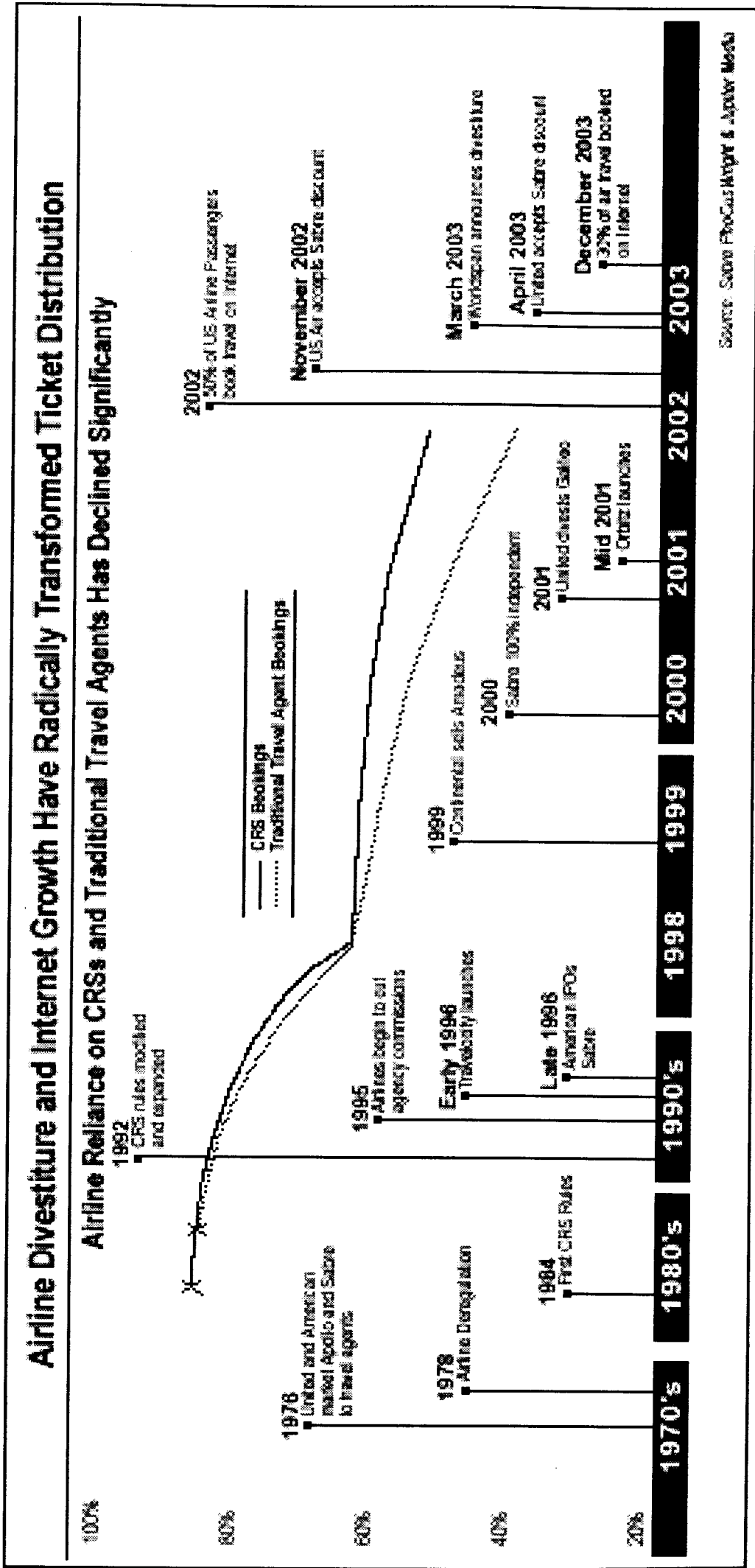


Figure 16: Internet Growth and Ticket Distribution

Source Sabre Holdings (PhoCusWright and Jupiter Media), copyright

### 2.1.4.3.1.2 Tour Channels:

Tour distribution has another component in the channel, because the tour operator acts as a 'bundler' and a reseller. That is the suppliers will provide inventory, the operator bundles that, makes a cost plus price point that includes marketing and distribution costs, and uses several channels at the same time.

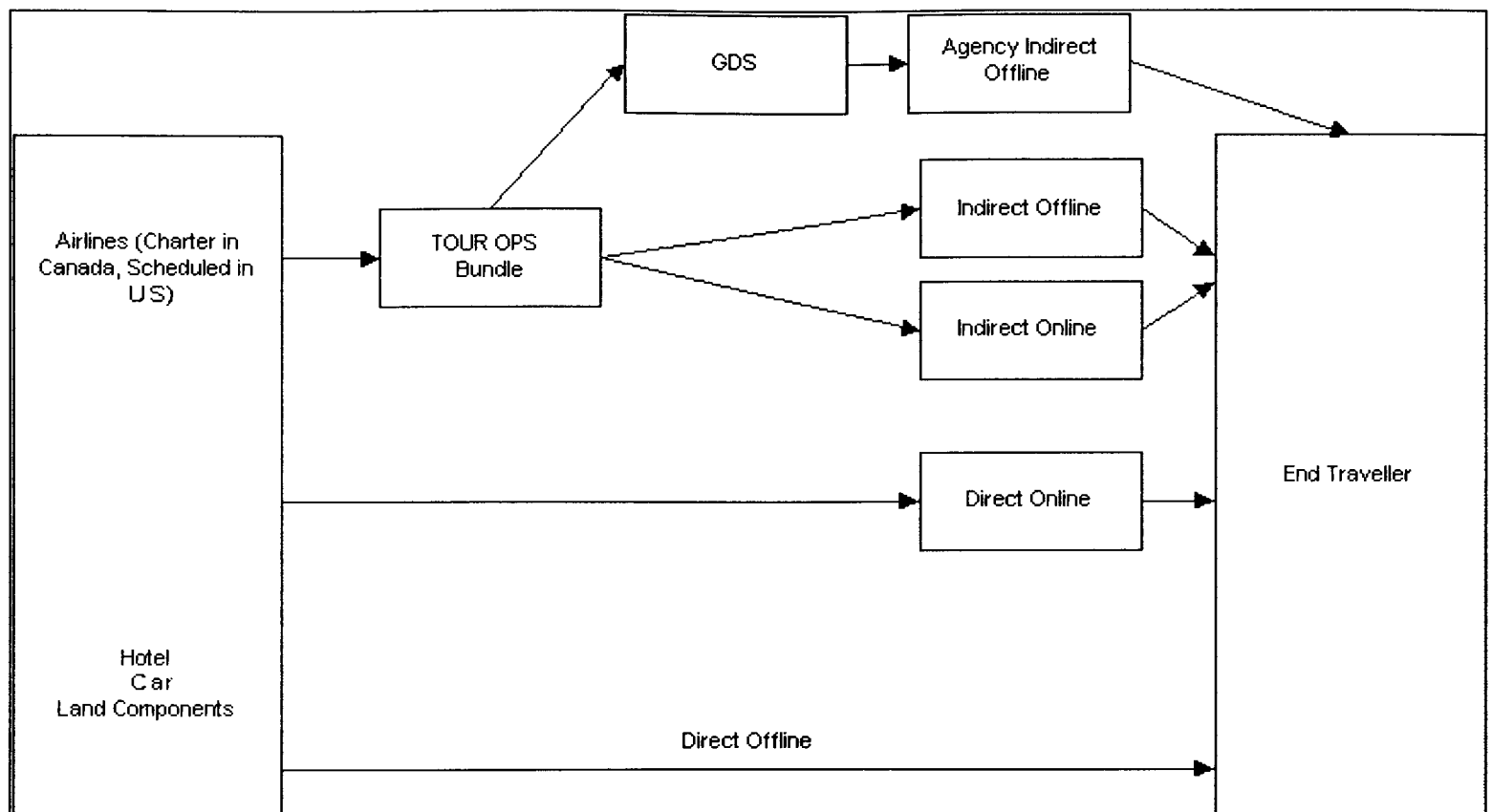


Figure 17: Tour channels

*By author*

### 2.1.4.3.1.3 Tour operator costs per channel

PhoCusWright Inc. estimate that costs are approximately \$10 for a GDS/agency booking, and \$30-\$40 for a direct telephone booking<sup>56</sup>, though this does not take into account the commission to an agency. The cost for a tour operator to distribute via a travel agency contains a number of fees: the fee to Sabre for example, was on average \$7.21 USD in 2002, per booking (not per segment), the switch fee can be anywhere from \$1 to \$8 USD per booking (not per segment), and the agency commission can be 10-15% of the gross value of the sale.

<sup>56</sup> PhoCusWright Inc., (2002). "Selling Vacations: The Online/Offline Challenge", p. 11



#### **2.1.4.4 New Entrants**

There are a number of new and potentially new entrants to the travel distribution industry. So called 'Newcomers' are changing the competitive landscape: USA Interactive (now called InterActiveCorp) purchased the online consumer service, Expedia in 2003. It also purchased the TV Travel Group, with plans to launch a USA Travel Channel. Worldspan has launched a TV travel channel with Digeo, and the A&E TV channel have plans to start selling travel packages designed around TV programming, online.

In Canada there are a number of new players developing methods for accessing tour operator content and presenting to a browser, see section 2.1.5.4 for a description.

#### **2.1.4.5 Emerging Models for Tour Distribution**

Tour distribution is subject to all the forces described so far, and in addition, there are two developments to highlight. These are the emerging technologies are enabling more choices for operators, intermediaries, and consumers, and a new business model is emerging called merchant model. Consider that travel intermediaries are competing to provide the best content for online consumers; Canadian tour operators are presenting their products on their own websites, Orbitz have ski and spa mini –websites, Cendant has promised to leverage its travel assets such as hotel and cars, for horizontal and vertical integration. For example, it may combine its content of Days Inn, with its distribution (via a Galileo booking engine) on a website it owns, such as Trip Network.

##### **2.1.4.5.1 Disruptive technology – Dynamic packaging**

Dynamic packaging is an algorithm (a method) that allows for combining travel components 'on the fly', and is best understood in terms of a comparison against FIT travel. Consider the following scenario: An FIT consumer asks a travel agent for a flight to Mexico outbound on a Monday, inbound the next Monday, with 5 nights hotel at the destination, 2 nights without accommodation but car rental instead. The agency will check a tour operator in the GDS for all of these components, and book a commissionable package if one is offered and available. If a tour operator does not have such an offering (or it is not available) the agent will deal with a wholesaler by phone/fax. The wholesalers will then search for air (schedule or charter) availability on a GDS, search the GDS for hotel and/or their own database for a 'land only'

component. The wholesaler will combine these, price them and send the enquiry back to the agency as a net remit, for the agent to mark up to a retail price. All of these actions take time and so these costs are built in to the final product.

Now consider the online consumer: the rise of the Internet has raised expectations to be able to explore the rich content available per component, to shop and build their own packages. Dynamic packaging will allow a consumer to search for such multiple components with one query, from a website. That is, it will enable an online query that captures all the parameters at one entry, and searches many databases simultaneously, to present a number of options including price, almost instantaneously. The suppliers and packagers will resist such an 'unbundling' of their offerings; suppliers will want to control the amount of inventory that can be accessed this way as it may dilute their overall yields, and cause them to lose control over pricing on this inventory.

There are barriers to widespread adoption of dynamic packaging. A survey of technology providers by New York University and PhoCusWright Inc., found that while dynamic packaging is a major trend in software development, the legacy systems (GDSs) would inhibit market penetration. The top issues affecting development are software funding, the prevalence of such legacy systems, and concurrent comfort levels of travel agents, and the current demand<sup>57</sup>. From a Sabre point of view, there are two immediate challenges: a) getting suppliers and or operators used to the idea of giving agencies, like Travelocity on-line re-pricing decisions (in order to win them the sale), and b) being able to develop an effective computer model to estimate the effectiveness of one package compared to another. The second capability is critical for Sabre to be able to cross-sell effectively, at yields that it can control. Sabre Research is actively working on developing these techniques as part of their yield management activities. Dynamic packaging is available on Expedia, and Travelocity, in limited form. The impact on tour distribution could be enormous if this type of technology becomes widely deployed.

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<sup>57</sup> New York University and PhoCusWright Joint research (2003), "Building the online vacation package marketplace: survey results", p. 5

#### **2.1.4.5.2 Merchant Model**

Travel intermediaries are also taking inventory positions. This means that the online agencies such as Expedia, Priceline, and Travelocity who have offered pre - packaged vacations via links are now taking positions on the inventory with an emerging business model, the Merchant model. The premise is that by leveraging maximum reach for the supplier, the intermediary can reduce prices for consumers and improve margins in between. For example, Expedia has started its own merchant model for hotels, some air, and car. With the merchant model, the distributor takes some risk on the inventory in exchange for a guarantee of certain business volumes. Sabre Travel Network has recently started a merchant model for its hotel distribution; it can negotiate risk on an amount of inventory with a national hotel chain, leverage its travel agent desktop market share in North America, and negotiate the best rate. The GDS intermediary then sells that rate via the regular agency channel, but acts as the merchant by paying the agency commission directly. Acting as a merchant enables a higher level of gross profit per transaction compared to the agency transaction model and provides best prices to customers compared to agency transactions. Sabre's Travelocity hotel merchant programme has grown to more than 4,000 properties. The merchant product, with its mix of revenue components is able to earn three times the revenue as the Sabre published (transaction fee based) product; an important metric is the percent of merchant hotels to published hotels.

Expedia does the same and leverages their online community; they now have 10, 000 hotel properties signed up for this programme. In 2002, so called 'merchant transactions' comprised 58% of Expedia's total revenue of \$591M USD, who do not have to pay commissions to travel agencies this way. Further, by integrating merchant inventory with their technology platform Expedia is increasingly able to dynamically bundle and price a variety of travel components to suit an individual customer's requirements. That is, they combine the merchant model with dynamic packaging, and as a result their vacation packages business in the USA is growing quickly. The US pre-packaged market is predominantly FIT, which means that this model will prove to be very attractive to the individual online leisure traveller. In Canada the ability to dynamically search will be slowed by the legacy tour operator databases, and the reluctance of the operators to give up control of their positions.

Not all of the hotel suppliers are willing to participate. For some years hotels have felt the pressure on their margins and some are tempted to provide the lowest rates to an intermediary, in exchange for a broad reach. Others are trying to develop strategies that enable the to regain control of their pricing. For example, Starwood hotels, and the Six Continents branded hotels are

offering the lowest rates to consumers directly, not to intermediaries. Hilton, Hyatt, Intercontinental, Marriott, Starwood, Pegasus and Priceline (the online agency) have a website called Travelweb, which is starting to offer hotel merchant content directly to consumers.

## **2.1.5 The Competitors for Tour Distribution**

In this section Sabre's major competitors for the North American Tour Distribution industry are described. There are three areas of interest – offline agencies (GDSs), online agencies, and miscellaneous technology providers entering the distribution space. See Table 15, the Canada Competitor matrix, for a summary description.

### **2.1.5.1 Global Distribution Systems (GDS)**

#### **2.1.5.1.1 Galileo International**

Eleven major North American and European airlines such as United Airlines, Air Canada, British Airways, and US Airways founded Galileo International, with data processing centres near Chicago USA, and Swindon, UK. The company uses a network of sales and marketing teams around the world and is known as Apollo in North America and Japan. In 1997, Galileo International became a publicly traded company, listed on the New York and Chicago Stock Exchanges. In October 2001, Galileo became a subsidiary of Cendant Corporation (NYSE: CD) headquartered in New Jersey, USA, and the cornerstone of Cendant's Travel Distribution Division. The Cendant Corporation owns other travel firms such as CheapTickets.com, (a consumer online travel service), as well as travel suppliers such as Budget and Avis vehicle rental firms, Ramada Hotels, Travelodge, The Days Inn, as well as several financial and real estate firms. In 2002, Galileo had 39% share of all GDS bookings in Canada, and 20% in the US. Galileo has a product called Leisure Shopper that acts as Sabre Tours does, see section 3.1.8.2. That is they provide agency access via the legacy switches in Canada, and have common host applications in the US for operators to automate their bookings via travel agencies. In late 2002, Galileo launched e-Agent, in partnership with SoftVoy@ge in Canada which will be an entirely web based tool for agencies to shop and book participating tour operators, via the operators' websites. That is, Galileo will be framing the Tour Operators website, the reservation will happen on a direct B2B model between operator and agent, but there is a merge back process into Galileo GDS, so that the GDS/agency obtains commission payment from operators, and productivity booking credits from Galileo respectively. It is not clear how much or to whom the operator is

paying for the booking. If this product becomes widely adopted among Galileo agency subscribers, they will sunset Leisure Shopper.

#### **2.1.5.1.2 Amadeus Global Travel Distribution S.A.**

In 1987 Amadeus was founded by Air France, Iberia, Lufthansa, and SAS, (no longer a shareholder), is headquartered in Madrid, Spain, and has its' data processing centre in Germany. In 1989 Amadeus offered neutral flight availability displays to meet EEC regulations, by 1997 had launched its own consumer online travel service, and by 1999 began quoting fares in Euros. Later that same year, Amadeus began trading on the Madrid, Barcelona, Paris and Frankfurt Stock Exchanges. Amadeus enjoys its highest market share of GDS bookings in Europe; in The USA it reached 9% in 2002, and about 2% in Canada.

Currently Amadeus does not have a point of sales tool for agencies, or a tour operator distribution product. They have an arrangement with Worldspan that enables bookings made by Amadeus connected agencies to funnel through a Worldspan engine, (Tour Source) and back to Amadeus. However, Amadeus have been active in the tour market with two significant developments. In 2000, Amadeus formed a partnership with a firm called Fourth Dimension Software, to form Atinera. Their goal is to bring functionality and capabilities to the tour market place with software and platform engineering specifically for this segment. That is, inventory management, reservations, and distribution services via proprietary hardware and software infrastructure. They are actively developing dynamic packaging solutions, and are due to release a product called VacationFinder in the second half of 2003, for use by tour operators in their own websites. Secondly, Amadeus purchased Vacation.com, a consortium of retail agencies, primarily in the US. A consortium is an aggregation of retail agencies and in this case, is attractive to agencies primarily for the benefits gained by leveraging purchasing power over suppliers. This marks the first ownership foray by a GDS into the retail space.

#### **2.1.5.1.3 Worldspan**

Worldspan was founded in 1990 and is co-owned by Delta Airlines, Northwest Airlines, and AMR's American Airlines. Worldspan is headquartered in Atlanta, USA, has three primary lines of business: travel distribution, e-commerce and travel supplier services. In addition Worldspan is the leader for transacting Internet bookings, processing more than 50% of all online travel agency bookings, by being the booking engine behind Expedia, Hotwire, Priceline and

Orbitz<sup>58</sup>. Worldspan had about 26% market share of GDS bookings in the US, and 5% in Canada, in 2002. Worldspan have 29 US tour operators distributing through a host-based text based, application. They also have a 'world ledger 4000 AS/400' platform that integrates with tour operators who have their own inventory systems.

## **2.1.5.2 Online Reservation Systems**

### **2.1.5.2.1 Expedia Inc.**

In 2002, USA Interactive purchased Expedia Inc (NASDAQ: EXPE), which is now ranked as the eighth largest travel agent (by volume) in the USA. Worldspan is the GDS booking engine for these bookings. Interestingly, the online agencies have several of their own distribution channels to attract customers. For example, Expedia's primary distribution channel is through their own country specific websites and an Expedia-branded spot on MSN.com, Microsoft's online services network. They also offer travel services via other travel firm's websites, sell direct to consumers by phone, and via a network of third-party travel agents.

Expedia purchased Travelscape Inc (a wholesalers of US hotel content), and through a division of Travelscape's called the World Wide Travel Exchange, WWTE™, are able to distribute hotel content to other websites, such as Alaskaair.com, and JetBlue.com. In early 2002, Expedia took another step into the tour market by purchasing Classic Custom Vacations in order to acquire their content, and use the company's proprietary ESP (expert searching and pricing) platform to facilitate shopping and booking for their online consumers. The ESP platform is built using dynamic packaging technology. Also, Expedia have an arrangement with Accovia to provide a broad range of Canadian tour operator content, similarly to the GDSs' switch arrangement.

### **2.1.5.2.2 Orbitz**

Five of the largest US carriers (American, Continental, United, Delta and Northwest) that command nearly 60% of the US domestic lift, came together to build a website to distribute their own inventory. Orbitz' owners do not distribute all of their inventory and fares to all sites and GDSs so there have been challenges with respect to Orbitz' purpose and design. The inventory has since expended to include other carriers' inventory, primarily in the USA, so the regulators are not sure yet if it is a website or a CRS. However the strategy has catapulted Orbitz to the US's

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<sup>58</sup> <http://www.worldspan.com/home.asp?fPageID=491>, accessed: July 22, 2003

second largest travel agency by number of bookings, within the first 6 months of its launch. While there is little proprietary technology, there are advantages of pricing which is driving its growth.

### **2.1.5.3 Other - US and International**

#### **2.1.5.3.1 Mark Travel**

Mark Travel is a retail organization that has diversified with into technology for use in the travel industry, in the USA. For example, VAX is Mark Travels' web based agency booking tool for tour components, which integrates with the leading mid sized agency back office product (TRAMS). In the fall of 2002, Mark Travel announced the Vacation Together Network (VTN) to provide marketing and technology tools (e.g. VAX), to enable small agencies an online booking capability. In this regard, they are making their own foray into becoming a consortium for agencies based upon technical capabilities rather than buying power.

#### **2.1.5.3.2 Priceline (lowestfare.com)**

Priceline launched its own vacation package product line in 2002, based upon the 'name your price' model, using its own negotiated inventory for air and hotel. Also, in 2002, Priceline.com and its affiliate Lowestfare.com signed a deal with one of the biggest US operators (GOGO vacations), to distribute their tour offerings online beginning in 2003, though it will not be sold as discount inventory. Gogo has a substantial amount of content - over 200 destinations on four continents, which will expand the product available for lowestfare.com considerably.

#### **2.1.5.3.3 Datalex**

Datalex plc, a provider of e-Business solutions for the travel industry, is a publicly traded company on the Irish Stock Exchange (DLE) and over-the-counter (DLEXY), based in Dublin Ireland, with about 250 employees. They have sales and operations centres in the UK, Singapore, Germany, Australia, and The USA. They provide solutions for airlines, hospitality service providers, corporations and travel agencies, via their BookIt Suite of products built upon their e-form BookIt Matrix™. This platform allows Datalex to integrate third party booking engines, databases and inventory sources. For example, their BookIt! AirWare™ is a product name for a management system for cruise lines and tour operators. It is a multi channel, tour management, accounting and distribution system that interfaces with GDS connectivity for real time

reservations, and includes revenue management for tour operators. The product also provides reporting capabilities to monitor sales, and marketing effectiveness, improved tools for planning and managing FIT travel, escorted programmes, and car and hotel management. They have a strategic partnership with Worldspan, in the US.

#### **2.1.5.4 Other - Canada**

##### **2.1.5.4.1 SoftVoy@ge Inc.**

This firm of 60 people is headquartered in Montreal and specializes in the development of commercial solutions for tour operators, consolidators, charter airline companies and travel agencies, in Canada. SoftVoy@ge has developed a B2C booking tool that enables agencies to sell tours to consumers via their own agency websites, pulling inventory from its own switch content, via any GDSs the agency is a subscriber of. They have also built a B2B solution for Galileo connected agencies that frames a tour operator website for agency bookings.

##### **2.1.5.4.2 TransiTours Inc.**

TransiTours, is headquartered in Montreal and positions itself as an online application service provider (ASP) and computerized reservation system (CRS) network for the travel industry, offering a suite of proprietary software including shopping, reservation, accounting and turn-key transactional web server packages. They recently completed a first round of financing for \$825,000. They have a B2B product called 'BookingTours', and have a newly signed revenue share contract with Sabre. They use a Sabre API to query the Accovia switch for shopping and booking and present to a web based browser on their website. They sell a monthly licence fee to Sabre agencies, and charge on a 'per booking' fee to Galileo agencies.

##### **2.1.5.4.3 Solars**

This firm is developing a common API, which means that it can be used to query any tour operator or charter airline database and present in any medium, including web based browser, a desktop GUI, or an icon on Sabre's eVoya WebTop. Solars can also house inventory, on a service bureau model, which gives it the ability to attract small nice operators who currently cannot afford the high costs of GDS distribution.



#### **2.1.5.4.4 Comnet: Tripeze/Sears Travel**

Comnet is a data communications firm that developed a product called Navitour, which is a B2B web based browser that is able to take query content from an operator (via the Logibro switch only), and present on a retail travel agents' desktop. There are plans to make this a B2C tool, by enabling searches and bookings of tour operators inventory directly from the Sears website, thus bypassing the switches and the GDSs.

#### **2.1.5.4.5 TripCentral.ca**

This is a B2C web site built by a travel agency that has the ability to shop across tour operators. The content is gathered from the switches, and a consumer who makes a booking is actually creating a request of the agency. The agency books in the usual way via the switch and GDS.

#### **2.1.5.4.6 Exit.ca**

This is a web portal that is owned by Transat A.T. Inc, and distributes primarily tour content from Air Transat Holidays. They have a presence as a consumer site, but they also have an arrangement with Sabres' Travelocity.ca to link from. This gives Travelocity in Canada a tour booking capability (albeit a third party link), and enables Air Transat Holidays to leverage Travelocity's marketing reach to provide them with another online channel.

## 2.1.6 Porter's Five Forces for North American GDS Tour

### Distribution

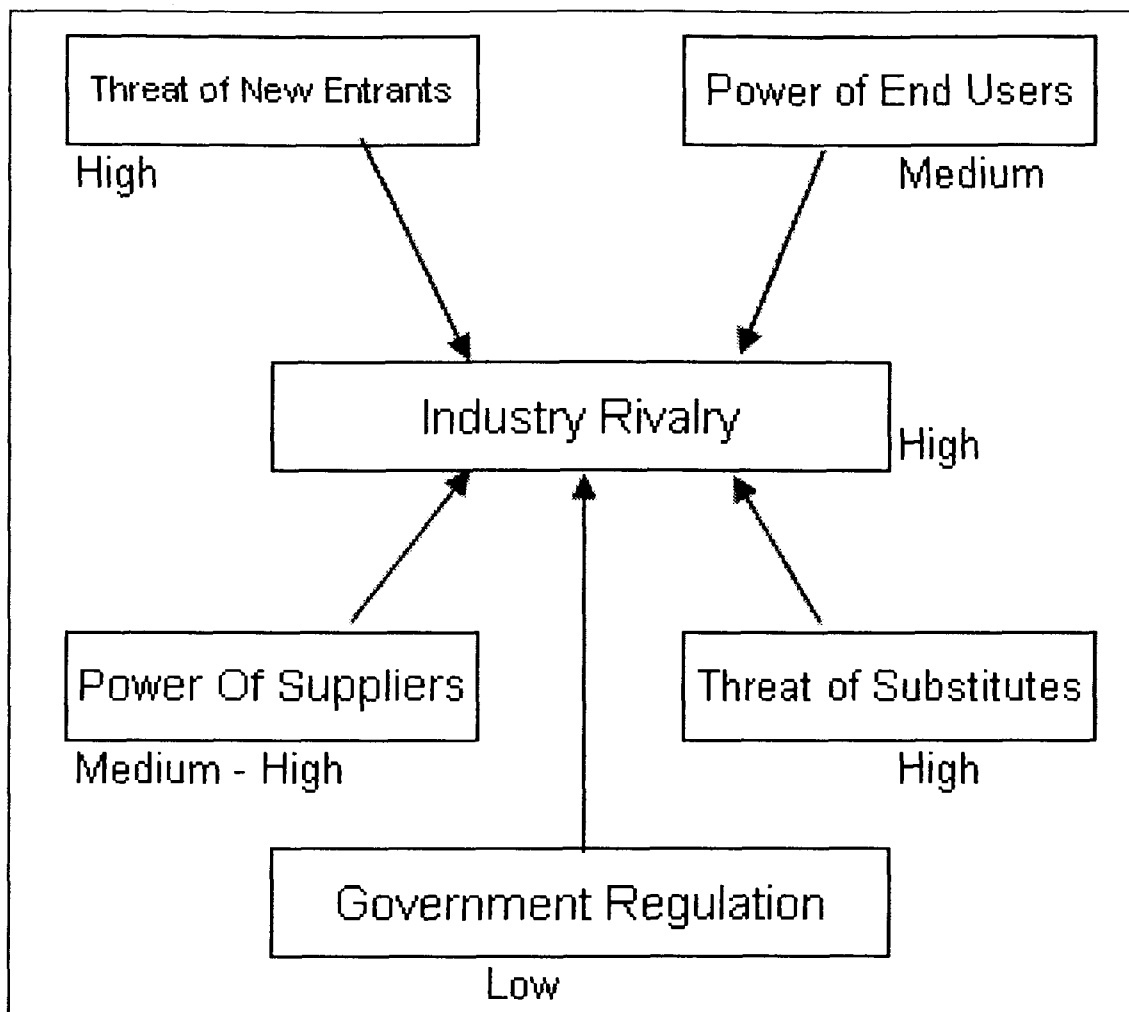


Figure 18: Porter's Five Force analysis for North American Tour Distribution

*By author, after Porter, 1985*

#### 2.1.6.1 Regulatory Environment

The US Department of Transportation (DOT) regulated the airline computer reservation systems in 1984. These regulations imposed restrictions on the CRSs in order to prevent them from abusive competitive tactics, to safeguard competition between the airlines, not all of which owned a CRS, and to benefit consumer choice. For example, a CRS had the ability to bias the flight displays a travel agent sees in favour of its' owner's inventory and pricing<sup>59</sup>. The regulations mandated unbiased screen displays, prohibited discriminatory booking fee pricing,

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<sup>59</sup> CIBC World Markets Equity Research (June 2003), "Industry Update – GDS regulations: Reviewing What's Important" p. 2

and required airlines to participate fully and equally in all the CRSs. The same rules are broadly applied in Canada under the auspices of Transport Canada. These regulations were revised in 1991 and applied to airline owned reservation systems, which by default meant all the players at that time. The GDSs have traditionally locked agencies into lengthy relationships by requiring travel agents to sign long-term contracts, (5 years in the US, 3 years in Canada). When the DOT in the US imposed a rule requiring that GDSs let client travel agencies do business simultaneously with competing GDSs, the GDSs responded by linking the prices and incentives they offer an agency to productivity clauses, in order to protect their desktop market share.

During the late '90s, three events unfolded that have caused a recent review of the regulations governing GDSs in the US. First, the rise of the Internet enabled some suppliers to distribute directly to consumers. Second, several of the largest US carriers formed an online agency named Orbitz to distribute their own air inventory and fares on the Internet, ostensibly to cut distribution costs, and circumventing the current regulations. Third, as airlines divested themselves of ownership in the systems, so the CRS rules are in danger of becoming irrelevant. That is, because the CRS rules apply to "airline-owned" GDSs, they only apply to Worldspan and Amadeus. In 2002, The DOT proposed extending the nearly 20-year-old rules, which would otherwise expire in January 2004. However, the US Department of Justice's antitrust division recommended deregulation of the CRSs, because the rise of Internet ticket sales and divestiture by the airlines of the reservation systems reduces the need for regulation. The DOJ recommends that very limited rules be retained, to address concerns about biased displays, and bias against carriers in the loading of their data and "possibly certain types of MFN" (most-favoured-nations clauses) in airline contracts. The DOJ specifically recommends that the DOT drop all rules that restrict the terms and conditions of CRS agreements with travel agents<sup>60</sup>.

The potential effect of deregulation are uncertain but it may mean that airlines and GDSs are able to negotiate more freely over the charges for GDS service, as the supply of inventory and fares becomes a free market. In Canada, Sabre Holdings are advocating that Transport Canada deregulate as per the US, but with the proviso that the rule obliging all content to all GDSs remains in place because of Air Canada's dominance in the market. The impact of potential future deregulation has to a certain extent been mitigated by recent actions of Sabre and Galileo. For example, Sabre is offering an agreement with major carriers where prices will be fixed for three

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<sup>60</sup> Data compiled from internal Sabre Holdings documents

years at an average of 12%<sup>61</sup> discount from present levels, in return for all of the airlines' fares and content. This is a strategy aimed at preventing further GDS bypass by the carriers.

Regulation for distribution in the tour business has not been as restrictive. Tour operators are not obliged to participate anywhere; they make distribution business decisions based upon the market for technology providers' abilities to automate processes and expose them to an audience. While the threat of regulations for the GDS business in aggregate is medium, it is LOW for the Tour Distribution market.

### 2.1.6.2 Threat of New Entrants

There have been several developments with respect to new entrants into the distribution industry. Traditionally this threat was very low, as the capital required building and maintaining such a system was far too great for most firms to entertain, plus the channel is a well-established one. However, the rise of Internet technologies has allowed individual suppliers to distribute directly to consumers, such as Hyatt.com. Several airlines have also done the same for simple routes and fares that do not require complex fare calculations or combinations with another airline carrier, and have also made lower fares available here than on the GDS. Such 'webfares' are outside of the current regulations for full GDS participation. In terms of a threat however, an individual supplier does not command the volume of business to threaten the GDS industry directly. An individual airline's actions are in theory mitigated by the limited number of destinations and fares they will be able to offer, and by the regulations that require full participation among all distribution channels, (though that ruling is at risk). A greater risk comes from a firm such as Orbitz which is a website designed by five of the largest US carriers (American, Continental, Delta, Northwest and United) that in total command nearly 60% of the US domestic lift, with the intention of bypassing the GDS channel. The site is now also able to offer inventory and fares on other carriers, though presumably without the highest level of connectivity. The rules governing this behaviour are unclear partly due because it is unclear whether Orbitz is a supplier website or a new GDS. For example, Orbitz has a 'most favoured nations' clause (MFN) with its own associate airlines, whereby if an associate provides lowest fares on their own website, then they must make it available to Orbitz. Thus, while the biggest US carriers are able to circumvent GDS participation with webfares, they are not able to bypass the Orbitz site. The Orbitz airlines' actions have successfully diverted booking business away from

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<sup>61</sup> CIBC World Markets Equity Research (June 2003), "Industry Update – GDS regulations: Reviewing What's Important" p. 9

the usual GDS/Agency channel. To date, it is unclear whether this strategy is a lower cost option for the participating airlines. Selling tour components are an imminent development for Orbitz to undertake, and the recent merchant model benefits will act as a catalyst.

In terms of tour bookings the Internet in theory creates opportunities for supplier direct to consumer bookings. To date these have not had a significant impact as the applications that will enable complex purchasing transactions are not ready, and the adoption for such online shopping experience is still in its infancy. The threat is a real and growing one however, as the operators try to reduce their distribution costs, software firms are spending their development dollars in this space, and the online consumer, while not growing in number as fast as the 90s, is trending toward a higher priced ticket purchase. The large Newcomers are threatening to enter the travel space and may find that targeting tour package sales is a natural first step, such as selling destination holidays in conjunction with history TV programmes. The technology, partnerships, and business models have not come into being yet, but continuing industry forces may encourage these developments. The threat of new entrants for Tour is therefore HIGH.

### **2.1.6.3 Power Of End Users (Travel agents)**

Travel agencies are a fragmented market, despite some consolidation and aggregations into consortia, and cannot exert significant buyer power on their own. Their internal processes and back office requirements are generally well integrated with GDS functionality, and as commissions have been reduced by airlines, so they have come to rely on GDS incentives. As long as the GDSs maintain the largest amount of useful content, and are able to revenue share the distribution fee, travel agents will find the GDS indispensable.

However, there are new choices and threats arising to encourage agencies to move their bookings off the GDS, and these may influence their power. For example, Air Canada's commands up to 70% of the domestic lift in Canada, and recently announced an agency only site with low priced commissionable web fares that are not available on the GDSs. If suppliers choose to (and are able to) distribute significant amounts of inventory outside of the GDS channel, the GDSs will become more competitive for the remaining booking share on the travel agent's desktop. This may have the effect of increasing the power of the end user because of their ability to play the GDSs against each other for incentives. As incentives rise, so the pressure on the GDS margin grows, and in an environment where GDS fee increases for suppliers will be difficult (or impossible) to maintain, so then the airlines will continue to encourage agency shift. To date, these impacts have not been felt, but the threat is growing.

In terms of the power of the end user on tour booking distribution for the GDSs, there is a greater threat. There is evidence of horizontal integration by travel agencies becoming owners of tour operators, such as the MyTravel Group plc. If these moves are sustainable, these agency firms may increase the power of the end users over the GDS. This is because they will be able to position their organizations as a more cost effective channel for suppliers to reach the end user, by using non – GDS technology. The power of end users is therefore MEDIUM-HIGH.

#### **2.1.6.4 Power of Substitutes**

The threat of alternate booking channels becoming established, is realised. Information asymmetry is fading and channel shift is established and accelerating. Sabre has been a leader in this development with success in its online agency, Travelocity, for many years. The new Merchant model of distribution is a significant threat to the GDS channel, if the online agencies can gather momentum by providing a better value to the traveller than an agency/GDS can. There are other ‘new to travel’ firms that offer aggregated merchant content via a web portal such as hotelleaders.com, based in Ireland and selling North American hotel content in North America. Technology firms that have made inroads into the travel distribution arena, once the sole domain of the GDSs are driving much of the power of substitutes.

For tour bookings there is a growing threat to GDSs due to developments in the online channel. There are a number of new players who are able to offer more cost effective alternative methods for tour operators to distribute their products. At the same time, these new methods are enabling agencies to make booking off the GDS, and offer superior service measured in response time, and quality of value added information to their customers such as destination information. Sabre is in competition (channel conflict) with itself here: the GDS/Agency channel does not have the technology that Travelocity has recently acquired. There are barriers to adoption for these substitute channels not least of which is their lack of interoperability with agency internal systems, but the threat is becoming more viable. Dynamic packaging poses a significant threat here, as operators will soon be able to make their products (and rich content) available direct to consumers at less cost than the traditional model. The threat of substitutes (to the GDS/Agency channel for Tour) is therefore HIGH.

#### **2.1.6.5 Power of Suppliers**

The largest air suppliers are insolvent and driving changes to current fees and models. However, this risk is somewhat mitigated by their reliance on the GDSs for the bulk of their

current distribution, and therefore, revenues. Smaller suppliers are likewise experimenting with alternate channels, and while these may provide for lower costs of distribution initially, they will not have the worldwide reach provided by the GDSs. For example, Westjet, are distributing direct online (with commissions to agencies), and have recently joined the indirect offline (GDS) channel in order to broaden their reach into markets where they are less well known.

#### **2.1.6.6 Competitive Rivalry**

The overall competitive Rivalry for Tour bookings in the GDS channel in Canada is therefore HIGH.

### **2.1.7 Summary of the factors impacting Tour Distribution**

#### **Industry Structure**

The Table 6 shown below is a summary of the factors that affect the tour distribution industry. The disparate nature of the industry and the information sources means that in order to summarize the situation for Canada, a review of all pertinent North America wide factors is considered. For example, where no reliable tour forecast figures exist for Canada, this project substitutes forecasts for the USA.

TRAVEL DISTRIBUTION	RATING	COMMENTS
Market Size – North America	USD\$240B	Experiencing shift in demand for product types
Scope Of Rivalry	International	New competitors as new models, technology, and channels emerge
Market Growth Rate – US	Modest Growth Forecast for Tour is higher	3% 4%
GDS: Stage in life cycle	Mature	Since 1953
GDS: Number of companies	Four	Oligopoly
Online Agency: Stage in life cycle	Rapid growth	Since 1995, online adoption rate may be slowing
Online Agency: Number of companies	>Many	A few are dominant
Supplier Customers - Canada	2 Charter airlines, Several Scheduled airlines available for charter	Looking for cheaper distribution
Tour Operator Customers - Canada	> Many small niche players. ~ 5 largest in Canada. Usually have their own technology for web sites	GDS provides for broad desktop exposure, but operators need cheaper distribution
Switches - Canada	2 dominate	Act as bottleneck for information distribution
Travel agency Customers - Canada	>Many	A fragmented market – looking for Tour shopping tools
End User - Customers	> Consumers have more information and choices	Looking for rich content and easy shopping
Degree of VI - Canada	Mixed	Some online agencies have traditional travel agency functions and vice versa. Some tour operators are integrating retail and vice versa
GDS - Ease of entry / exit	Difficult	High start up, maintenance costs, entrenched systems
Online Agencies - Ease of entry / exit	Easy to have a presence	Difficulty is in accessing live content, attracting bookers
Technology/innovation pace	Fast	Driven by the rise of internet technologies & innovation
GDS - Product characteristics	Established and integrated	Text based, no content
GDS - Travel Products	Comprehensive range	No cross Shopping
GDS - Ease of use of technology	Not simple – requires special training	No offline agency web presence



Online Agencies - Product characteristics	New and Fun, new products coming onstream	Many lookers, too few bookers
Online Agencies - Travel Products	Limited range, but suited to FIT travellers	Simple itineraries are available, dynamic packaging is the new frontier
Online Agencies -Ease of use of technology	Easy	Intuitive GUIs

Table 5: Template

*By the author, adapted from Thompson A., Strickland A. (1998)*

## 2.1.8 Conclusion

An analysis of the travel distribution industry can be summarized according to societal, technological, political, environmental, and economic macro variables. The societal pressures are mounting as consumer behaviours drive expectations of better information, more choices and travel products on demand. The technological changes (both discontinuous and trending) are driving shift to new channels of distribution, enabling new competition, and reconfiguring of the value chains. In Canada the switches and GDSs are in a pivotal position with respect to be able to facilitate and control new channels for tour distribution, yet there is a rise in small developers building solutions around them. The political and health situation in the world is depressing demand for travel in general. This is threatening the existence of the high fixed cost network carriers that dominate the industry, such as Air Canada, yet leisure travel and low cost carriers are not experiencing the same declines. The growth in tour travel is not predicted for any one channel. In Canada the tour operators have been subject to ownership changes and three multi national firms now handle the bulk of tour distribution. The US regulatory bodies are on the verge of deregulating the supply for non-tour distribution. There is evidence of new business models and new technologies emerging as these macro variables are changing.

### **3 SABRE INTERNAL ANALYSIS**

The purpose of an internal analysis is to identify the existing and potential sources of rents and impediments to rents that are internal to Sabre <sup>62</sup>.

Sabre Holdings is engaged in the distribution of electronic travel inventory through its proprietary reservation system, Sabre. Its business was for many years described as a transaction technology for the distribution industry. The firm's efforts were spent on software and other technology services for the travel industry, and of course, ensuring that bookings drive through the system. The forces in the industry in the last ten years have caused Sabre to re-evaluate itself and undergo a number of transformations. Sabre Holdings now has four lines of business, three of which provide distribution services, two of which provide tour distribution. The firm has recently begun describing itself in terms of travel commerce rather than travel distribution.

#### **3.1.1 The Value Network and the Travel Value Chain**

Sabre creates value for its shareholders by means of a value network see section 1.4.8. This value network structure (Figure 19) was well suited to facilitating the travel value chain as shown in Figure 20, below.

For many years Sabre earned rents on primarily involved in shopping, selling and fulfilling in the travel shopping value chain, and developed applications (products) to enhance an agents' capabilities here. For example, Sabre provided "Sabre for Windows", a Sabre interface for travel agencies and associates that provides complete Sabre system functionality in a Microsoft networking peer-to-peer environment. This allows users to share resources on their computers and to access shared resources on other computers without the need for a central file server. This translates into a lower monthly bill for the Sabre customer. Subsequently, Sabre built eVoya Webtop. This is the product name for a browser-based travel agency resource centre and booking tool that integrates the Sabre system with the Internet, on the Sabre desktop. Tour bookings are excluded from this arrangement. Sabre also provides agencies with the opportunity for a web presence if they choose to use Sabre.Res. This is the product name for a site that is co-branded by Sabre and the agency that enables consumer bookings to be made on the Sabre host,

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<sup>62</sup> Boardman and Vining (2002), "A Framework for Comprehensive Strategic Analysis" p. 12

and queue back to the agency for fulfillment activities such as payment processing, ticketing, sales and service.

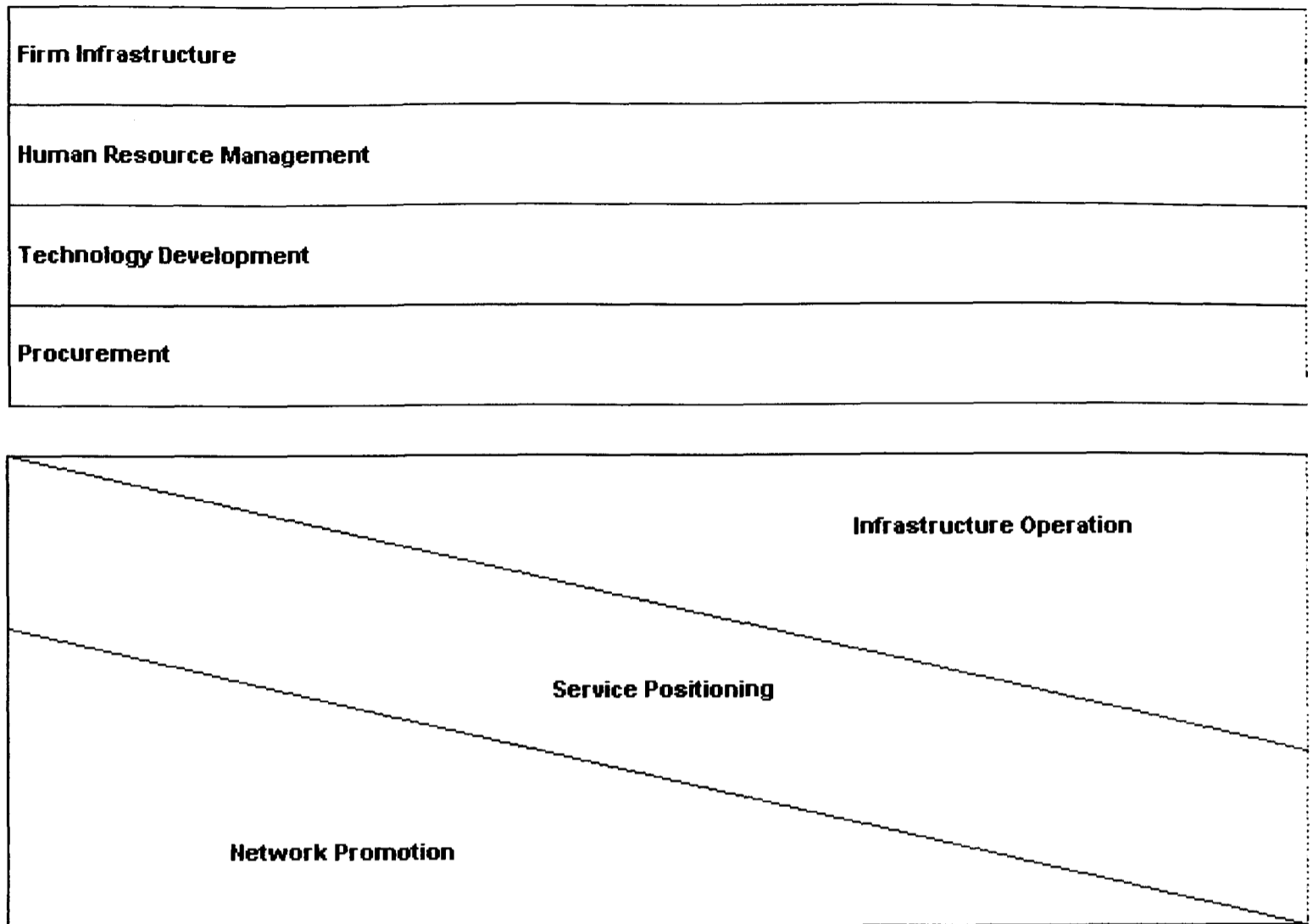


Figure 19: Value Network

*By the author adapted from Stabell & Fjeldstad, (1998).*

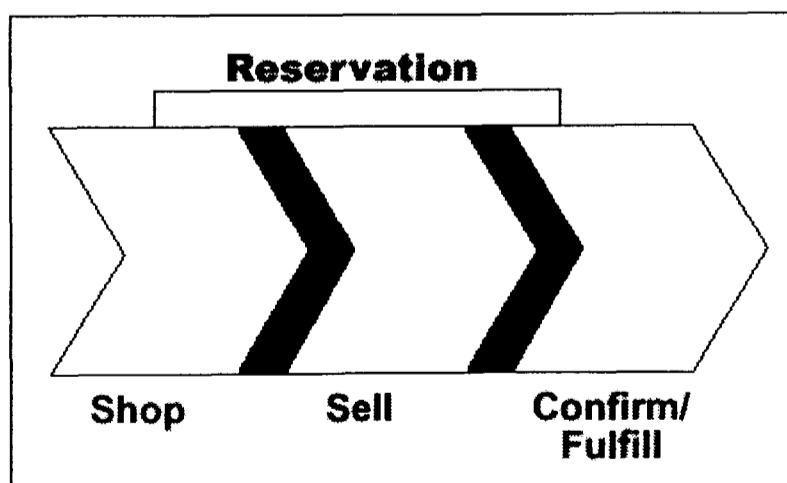


Figure 20: GDS Traditional Travel Value Chain

*By author, adapted from Sabre Holdings*

Sabre reacted to the gathering forces of change in the industry by broadening its scope along the travel value chain. According to Gurbaxani and Whang, network type businesses (such as a GDS), benefit from horizontal growth because they may be able to decrease external coordination costs <sup>63</sup>.

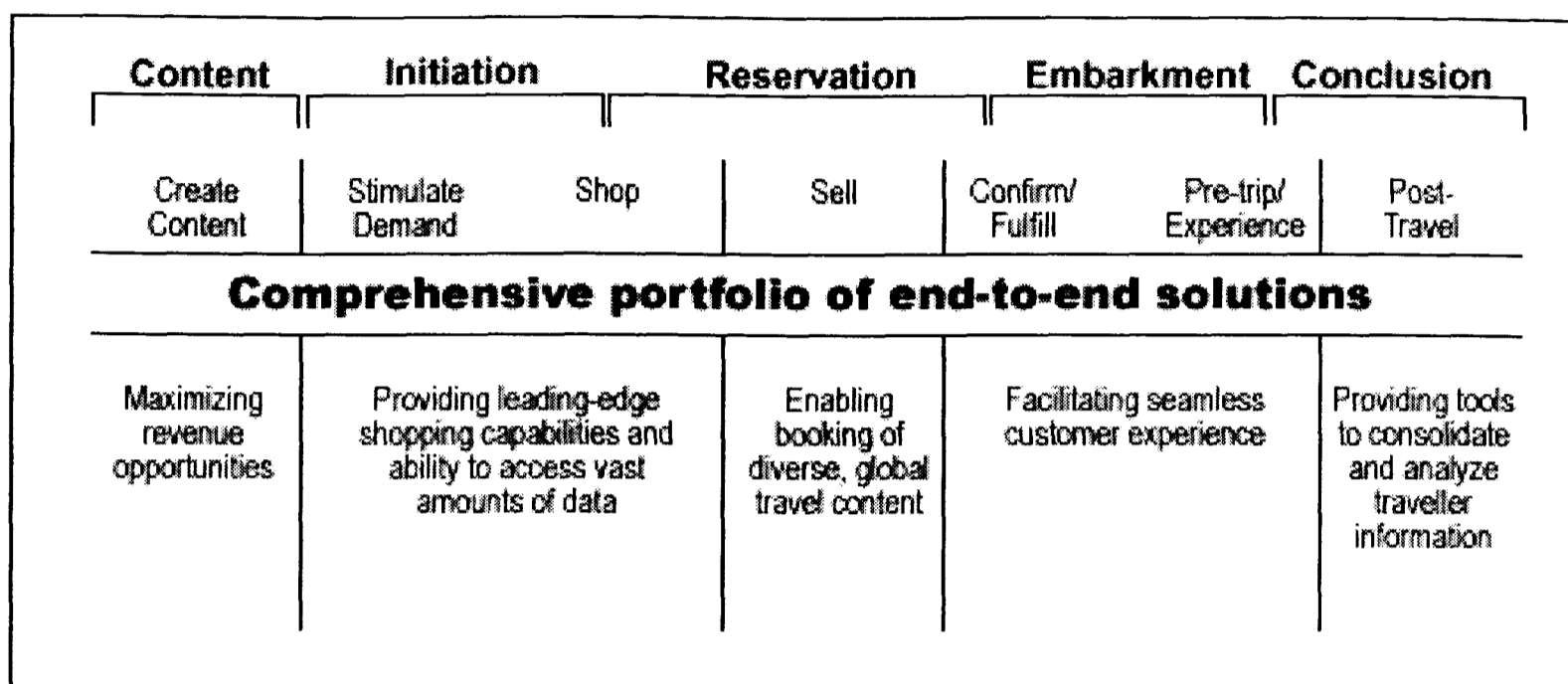


Figure 21: GDS Expanded Travel Value Chain

Source – Sabre Holdings - copyright

Sabre innovated a number of products for use in different areas along this chain. For example, it seeks to branch outwards along either end of the travel value chain, and capture more of the traveller spend by so doing. Each step of the chain has had product development applied to it. For example, acquiring and integrating Site 59 is part of stimulating demand, and Sabre inform (a technology platform that enables access to traveller information services regardless of mobile device), is part of the pre trip experience. The company see itself as providing a comprehensive end to end portfolio of solutions, that maximize revenue at the content creation phase, provide leading edge shopping and booking tools for the shop, selling and fulfilling phases, and facilitating seamless traveller experience for embarkation, and tools to analyse traveller data.

However Sabre has not been able to charge for many of these products because the basic business model is still that of an agency transaction one, in a time of declining commissions to agents and fluctuating demand for certain types of travel. The GDS competition for desktop market share in recent years has been focussed on these ancillary products and incentives, so the

<sup>63</sup> Gurbaxani, V. and Whang, S. (1991). "The Impact of Information Systems on Organizations and Markets" Communication of the ACM, January 1991, Vol. 34, No. 1. p. 66

ancillaries are usually included in the contract negotiations as ‘value adds’. Sabre has maintained its revenue by increasing its market share via this method, though the channel shift has taken transaction revenue away from Sabre at the same time.

### **3.1.2 Sabre’s Strategy Overview**

Sabre is a publicly traded company where the majority of shareholders are institutions; the firm is expected to maintain its leadership position within the industry, and provide superior returns, over its weighted average cost of capital (approximately 14%)<sup>64</sup>. For some years, Sabre was committed to “transforming the travel of business through innovation” as its strategic objective, but has recently changed to ‘win an increasing share of traveller spend by transforming the business of travel’. The key assets for strategic use are a leading online travel service provider (Travelocity), the largest desktop market share of travel agencies, (Sabre Travel Network), a comprehensive suite of airline products, (Sabre Airline Solutions), a leading corporate booking tool (Getthere), and stable well-established technology and marketing teams with deep industry knowledge.

The key strategic objectives are:

- ◆ Forge direct, loyal relationships with leisure and business travelers
- ◆ Understand, shape and influence travellers’ product selection
- ◆ Leverage our worldwide distribution assets
- ◆ Lead transition to new travel commerce and distribution business models
- ◆ Extend leadership in providing value-added technology to customers.

### **3.1.3 Organizational Structure**

The key assets for strategic use are its four business units plus stable well-established technology and marketing teams with deep industry knowledge. Sabre Travel Network (STN) is supported by headquarters in Texas, and has divided the field based units into geographic regions around the world, such as Latin America, EMEA (Europe, Middle East and Africa), and Canada is within STN North America. The responsibility for tour distribution for Canada resides with Sabre Travel Network’s Leisure Department in Texas for the agency channel, and with

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<sup>64</sup> Data compiled from internal sabre Holdings document

Travelocity.ca also based in Dallas. STN Canada has one employee as the ‘leisure manager’ to act as advocate for the market.

### 3.1.4 Strategy Review

An important factor in the current travel and travel distribution industries is uncertainty. This project has shown that there exists a high degree of uncertainty, a level 3 type of uncertainty according to Courtney, et al <sup>65</sup>. Sabre has chosen to act as a ‘shaper’ in this circumstance, that is, to take a leadership role by creating new opportunities to take control of the direction of the travel distribution industry. Shapers will usually involve taking big bets, such as Sabre has done by going 100% public, buying back Travelocity, purchasing Getthere.

This means the company has changed from describing travel commerce as a transaction activity and fee based model, to describing travel commerce as the retailing of products. To do this Sabre will expand the product portfolio to lower their reliance on traditional airline booking fees, and grow through the merchandising of travel products and through online distribution. This will enable an increase in revenue per transaction, and enhance merchandising capabilities to meet new kinds of consumer demands. To the investment community Sabre positions itself as “the world leader in travel commerce, by retailing travel products, and by providing distribution and technology solutions to the travel industry”. Sabre’s entry into retailing means it is trying to reconfigure the value chain, transform the business of travel, and possibly erect barriers to protect itself.

This departure from the transaction model is based upon an analysis of the entire travel opportunity, and addressable revenue. That is the company has made a strategic decision to become a leader in commerce by attracting addressable revenue, rather than a transaction fee. A method for doing this is currently under evaluation – a project called the merchant model programme for hotels. Consider that current worldwide ‘travel spend’ is about \$740B USD, which is the gross value of sales of all travel products, regardless of channel, consumer type, or component. In Canada, and The USA that value is \$239B USD, of which Sabre transacts approximately \$2B USD gross, based upon supplier paid sources. Addressable revenue includes additional revenue flows around the gross travel spend, such as service fees paid by consumers, commissions and incentives paid by suppliers that Sabre is not party to. The addressable revenue opportunity is a way of considering all the opportunities for revenue that currently exists in the

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<sup>65</sup> Courtney, Hugh G., Kirkland, J. and Viguier, P. (1997). “Strategy Under Uncertainty,” Harvard Business review, 75 (6), p. 66-79

travel industry model, beyond a distribution fee opportunity. The current 2002 addressable revenue across the four lines of business that Sabre Holdings own is \$7.76B USD, of which Sabre Travel Network and Travelocity could access \$3.72B USD. This means that instead of considering the market size as \$239B USD, the opportunity is much bigger at \$7.76B, see table 7 below and figure 34, appendix A.

	<b>2002</b>	<b>2006</b>	<b>Increase</b>	<b>Segment</b>
Travel Spend	\$239B	\$271	3.1% annual growth rate	Fasted growth rate will be in hotel @ 3.2% pa
Addressable revenue	\$7.76B	\$9.14B	4.1% annual growth rate	
Sabre's gross revenue	\$1.42	Aggressive planned growth in revenue		Fastest growth segment will be online leisure and unmanaged business @ 18% pa

Table 6: Travel Spend and Addressable revenue 2002 - 2006

*By author, data compiled from internal Sabre documents*

The challenge will be to remain viable as a distributor, while transforming into a travel retailer that is able to access more of the addressable revenue. Currently over three quarters of the firms' revenue comes from the Sabre Travel Network distribution fees. The intention to attract addressable revenue has not yet been worked into the strategic objectives, but is considered in this project because the strategic recommendation for Canada should take this notion into account.

At the corporate level, the company aspires to lead the changes in the travel industry by driving growth through its four lines of business. The strategic objectives per line of business are:

- ◆ Sabre Airlines Solutions: Expand presence in low cost carrier segments, continue international diversification, and enable next generation of business models.
- ◆ GetThere: Drive increased adoption and a global presence, and deliver additional value added services
- ◆ Travelocity: increase customer acquisition, and migrate to higher margin products via merchandizing and targeting the unmanaged business traveller
- ◆ Sabre Travel Network: target sustainable agency segments globally, leverage technology leadership, enhance supplier offerings, and increase merchant product sales.

These four lines of business means the firm is positioned to provide services to all the players in the supply chain: Travel suppliers, end travellers, re-sellers, travel agencies, and corporations. The firm wishes to collect more revenues that are available across all channels, components and consumer types.

With respect to tour distribution, Sabre has two different lines of business: Sabre Travel Network' Sabre Tours department, and Travelocity. The Sabre Travel Network's strategy at the Canadian division sales and service field level takes the corporate strategic objectives and expands them into two broad categories: maintain and transform the business. It does this along 6 dimensions: Targeted Growth, Big R, Pole Vault, Well Oiled Machine, Yeah baby and Ying Yang. Each dimension has a number of initiatives attached; in total there are 29 applicable to Canada, each with a number of goals, and measured over 3 success parameters.

This project will focus on the corporate level strategies as defined for Sabre Travel Network, not the balanced scorecard for Sabre sales and service in Canada. The reason is that currently the decision making process for Canadian tour distribution resides at the corporate level, (Sabre Tours) and not the field sales and service one. This project will therefore position strategy solutions for tour distribution against this background and will use profitability and market share as the primary proxies for performance.



### **3.1.5 Sabre Tours Current Strategy**

The Sabre Tours strategy of choice for a number of years calls for a rationalization of its' tour offering from five lines of product in both countries, to one that meets the needs for both countries. Sabre Tours is researching how to move from managing five host based lines of product (Tourguide, Tourlink Mark Travel, Tourlink AA Vacations, Access Tours SoftVoy@ge, and Direct Tours Accovia/Logibro), to one platform. Each line of 'product' is a resource intensive, text-based platform that serves different tour operators with different needs, and requires high ongoing maintenance within Sabre Tours. This project refers to this as a 'manage to one' strategy; it is a cost containment strategy, where the company is looking to be able to reduce the costs it incurs to manage tour bookings. This has proved difficult to accomplish in the US because of the fragmented nature of the business, the lack of standards, and resource constraints. It has proved difficult in Canada because of the power of the switches, the small size of the market compared to the US, and the decision makers are in the US.

Sabre Tours are scoping an initiative to develop a browser based tour solution for its travel agency customers that provides equal or greater functionality than Sabre Tours current product range, and maximizes the development efforts currently underway at a Sabre enterprise level. This means that in order to browse the operators and make reservations within the overall architecture changes underway at Sabre, Sabre Tours needs to scope functional specifications for all the client information to appear in a 'super' PNR (passenger name record). When the parameters of the Super PNR are determined and the issues around a new (enterprise level) Travel Data Warehouse are resolved, Sabre Tours would like to store the information on the itinerary page. This means that Sabre Tours is waiting until the larger enterprise issues are addressed and resolved before being able to a) specify the agency requirements for a super PNR along a range of query types, and b) then being able to develop a shop and book functionality that is able to query disparate tour operator data structures. It is also desirable to have the ability to seamlessly move booking information from the operators systems into Sabre, and then to third party back office systems and/or customer profile systems into the PNR. This is an all-encompassing solution at the data level for Sabre to manage its tour bookings cost effectively. It does not address how to compete for bookings in the evolving environment, nor enable Canada to reduce the risk of imminent GDS bypass, see the competitive matrix Table 15 in Appendix A.

The solution means waiting for Sabre internal systems to continue developing along their paths until they are able to accommodate a rationalized tour booking process. Sabre Travel

Network has not focussed on the Canadian tour area for a number of years because a) Sabre has the highest desktop market share (nearly 60%), the majority of tour bookings are via travel agents and via automated means, so Sabre is winning the bulk of the business. See sections 2.1.3.3.2 for a review of the booking process, and 3.1.10 for a review of performance. Meanwhile, the time frame for such a solution is unknown, and the risk is that Sabre's competitive position will erode as new entrants make inroads on the booking enhancements, affecting tour market share. There is no indication whether such an initiative will maintain Sabre's tour booking market share during development. Tour operators are actively searching for low cost distribution options, and there is also no indication that this alternative will provide that benefit, when it does become available.

Sabre Holdings also made a financial investment in Accovia in 2000 and now owns 10% of that company see section 2.1.3.3.1.2. The intention was to be able to influence product delivery, specifically for a tour shopping browser. However, to date there has been no delivery of such product.

### **3.1.6 Sabre's Technology Strategy**

In order to prepare for the future, the Sabre technology office (CTO), has a strategic roadmap along three dimensions: Building the service oriented architecture, (SOA) improved use of decision support tools (DSS), and focussing on strategic relationships with partners such as HP, EDS and Yahoo. The roadmap was built by considering what technologies best support the firm's business goals and by identifying consumer trends. Sabre's technology goals are to improve customer (supplier) value, bring products to market more quickly, and reduce unit costs. For example, the Service-Oriented Architecture (SOA) consists of software systems and interconnections that are server oriented - not hard coded, so that multiple applications and data sources can easily share information. One of the advantages of this "loosely coupled", multiple server approach is that changes can be made more quickly and cost effectively – fixes to an individual software module can be made without causing glitches with linked software systems. Sabre is using the new platforms within the SOA to offload selected functions – such as shopping, booking, and fulfillment – from the traditional operating system, in order to exploit new features while retaining the operational characteristics that have long been Sabre's hallmark, and to reduce costs. The DSS tools mean that improved statistical data analysis, forecasting, optimization, and algorithm engineering, will enable Sabre to increase their influence across the travel shopping value chain. They enable Sabre to react to changing business models quickly by providing the means to engineer costs downwards, and to master the application of directional

selling and yield management. The focus on partnerships at the CTO level means that instead of using Sabre resources to maintain non-strategic commodities, the company can focus on travel-related applications, research and development efforts, technology investments, and incorporate third party strengths, such as database processing, into Sabre solutions. For example, by identifying the consumer's need for more information, technologies such as XML are being actively incorporated within Sabres' secure environment.

### **3.1.7 Product Strategy**

Sabre's overall product strategy is aimed as being able to accommodate as many scenarios as possible, see section 5.1.1 and table 11. Products are designed per business unit (with some synergies between units), based upon maximizing the amount of return regardless of which scenario becomes reality. In practice in some cases this is actually an 'options' course of action, where modest initial investments can be made that allow decision on whether to scale up or back, a product can be made subject to market developments. There is evidence of the 'no regrets' courses of action, such as cost reduction initiatives, (Sabre has been aggressively cutting costs such as annual layoffs, since 2000), building skills, and developing good competitive intelligence, all of which are good things regardless of how events unfold.

### **3.1.8 Key Success Factors**

At the corporate level Sabres' key success factors are its entrenched systems for suppliers and travel agency end users, plus deep industry, marketing and technical abilities. For Sabre Travel Network, the past success was built upon using IT as a competitive advantage, using the benefits of informational scale to command a leading share at the point of sale. This drove the distribution industry to become an oligopoly, where differentiating by incremental product enhancements and relationship building with customers became the key success factors. Subsequently, innovating products along the expanded travel value chain, by leveraging deep industry technical and marketing capabilities, have been key success factors. The market share at the desktop remains a key success factor, but will no longer enable Sabre to remain a vital force in distribution. The previous success factors have not gone away entirely, but have been supplanted to a certain extent as the external forces have driven channel shift.

Recently the fundamentals of a guaranteed supply have become threatened. A key success factor for Sabre Travel Network will be the ability to drive 'a sustainable business

model', where the GDS remains vital. This means that Sabre and the agency channel must be able to improve the value of the GDS to the suppliers. As the external forces affecting the air industry have impacted the major carriers' ability to earn a profit, so they have applied pressure to the distributors to reduce fees and improve their value. Sabre has launched a programme to its major supplier customers to reduce and fix the segment fees (on average by 12%<sup>66</sup>) in return for all content. This initiative, called DCA3 (Direct Connect Availability for 3 years) is critical to the viability of the agency and GDS channel for a number of reasons. Many carriers have attempted to attract consumers and agencies to airline websites (the direct online channel), which is a direct risk to the GDS revenues. At the time of this project the signs are positive that as a few key airline suppliers sign on for this programme, it will likely encourage others to follow suit, and will mitigate the effect of GDS bypass. Airlines will be less inclined to fund their expensive and not yet widely adopted web channels. Orbitz is an exception because it is part website and part GDS: it is funded by the big five US carriers, has a loyal online following, and has achieved this success by offering 'web only' exclusive fares. If the owners of Orbitz sign on to the DCA3 programme they will be agreeing to supply Sabre and its agencies with the same 'web only' fares. The advantage that Orbitz has enjoyed may be coming to an end. Another key success factor will then follow on, which will be Sabre's ability to offer the suppliers a number of channels to choose from, i.e., the agency channel (STN), or online consumer (Travelocity), or corporate booking (Getthere). If successful, this initiative will enhance the likelihood that Solidarity prevails as the end state scenario, and that Portal Power is less likely.

Sabre Tours has a number of key success factors, primarily its ability to leverage the share of travel agency desktops. This commanding market share position gives Sabre Tours a cost effective way to help an operator reach a broad audience. Tour operators are attracted to as broad a reach as possible so that they lower per unit costs. The largest market share acts as a firm specific advantage in that it enables Sabre Tours to garner the largest number of tour operators to the system, and in that sense is a firm specific advantage. Having a large number of operators is critical to the viability of tour distribution in that without a broad range of tour content the capabilities for agencies to make bookings are reduced. A challenge with this scenario is that travel agency loyalty is not built by tour distribution and its products, but by the Sabre Holdings corporate level strategies and Sabre Travel Networks' deliverables. A travel agency renews its GDS contract every three years in Canada, and will choose to renew or convert, based upon their individual needs and a spectrum of capabilities, products and incentives offered by the competing

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<sup>66</sup> CIBC World Markets Equity Research (June 2003), "Industry Update – GDS regulations: Reviewing What's Important" p. 9

GDSs. For example, an agency chain may decide that despite superior tour product range and capabilities that Sabre currently enjoys over Amadeus in Canada, the agency may be swayed by perceived superior host functionality for air fulfillment, or a larger incentive to convert rather than renew. That means that the sustainable competitive advantage for tour distribution is not inherent in that product range, or Sabres' ability to provide tour technology products, but depends on the competencies of the firm in total.

Travelocity is the other line of business for tour distribution, and its key success factors are different from Sabre Travel Networks'. Travelocity is able to attract tour operators (the same ones), to its channel by offering a lower cost per unit, partly because of the technical efficiencies, and partly by removing the travel agency commissions. Its key success factors are its technical abilities compared with its chief competitor (Expedia), and its successful branding at the consumer level. Travelocity has attracted proportionally more internal development dollars than have Sabre Tours, as forecasts have predicted a higher demand for online than offline leisure, so Travelocity is gathering more capabilities for operators and consumers. These factors are somewhat mitigated by the slow adoption rates for higher priced ticket purchases online, and the ease and propensity for cross shopping web offerings, and the historically low ratios of lookers to bookers.

These two distinct lines of business have created some degree of channel conflict. Travel agencies rely on the GDS for all content and tools with which to make and account for bookings. Travelocity bypasses them and asks consumers to make reservations directly with a Sabre company. There have been agencies that are reluctant to renew their GDS contract as they sense that Sabre is trying to play both sides, to the detriment of the agency channel. There is the widespread perception that Travelocity will soon be better able to provide tour distribution, and thus eroding travel agencies competitive position against online agencies. Both lines of business however do have similar challenges with respect to the lack of standardization among tour operators.

In summary, Sabre' strengths in maintaining itself as a tour distributor come from its market share position, its deep industry knowledge, its technical capabilities, and that it is a leader in two channels. Its weaknesses are the funding constraints for Sabre Travel Network applied against the leisure forecasts, and the accompanying strategic oversight of a comparable, and viable tour product for the agency channel.

### **3.1.9 Sabre Holdings Tour Product Portfolio Analysis**

Sabre has three of its four lines of business working in distribution, and two are currently involved in tour distribution: Travelocity, and Sabre Travel Network (STN)

#### **3.1.9.1 Travelocity**

Sabre's online consumer service, Travelocity, has been distributing air, car and hotel product since 1995. In June 2003, Travelocity in the US only, launched a dynamic shopping engine that allows customers to book airfare and hotels with fewer clicks, and provides access to special rates not available when booking the components separately. Travelocity uses new technology (dynamic packaging) and by using its' 'bulk fares' from key airlines (these are distressed inventory via the Sabre host GDS), and adding its' negotiated rates with preferred hotel vendors, it can then acts as a merchant. This improves the offering to consumers and earns a higher return while providing packages direct to the consumer. This is in effect, acting as a bundler and reseller i.e. a tour operator. The new technology offers value-added travel planning and booking tools that give customers the most flexibility in customizing their trip; and broadens Sabres' ability to use specially negotiated merchant rates for airfare and hotels. The effect is that customers get greater access to discounts on their travel purchases, albeit using distressed (and therefore limited) inventory. This would be considered a consolidator strategy in Canada because the primary component is distressed inventory, not packaged holidays, or charter inventory. The next enhancement for the US is to be able to offer to add cross-sell displays of its' prices at multiple points on the flight purchase path. A key parameter for measuring success with this new capability is to improve the ratio of merchant hotel room nights, versus published hotel rates.

In Canada, Travelocity.ca serves the Canadian market by distributing air, car and hotel using inventory from the Sabre GDS, and has an arrangement with a national travel agency chain for fulfillment. Fulfillment refers to accounting and ticketing procedures, and call centre sales and service. Travelocity.ca has recently entered into contracts with Exit.ca, and Conquest to distribute tour content. Exit.ca is owned by Transat A.T. Inc, and is a web portal for Air Transat Holidays (ATH) product, which uses Air Transat aircraft predominantly. Exit.ca has a link from the Travelocity site to its own site for shopping and booking ATH product online. Conquest is a privately owned tour operator that charters air space wherever it can, and distributes via the usual channels, but provided Travelocity with its proprietary API. This means that a Travelocity.ca consumer is able to shop and book Conquest product from the Travelocity site, and Conquest is able to utilise Travelocity.ca's marketing reach, for a small per booking fee. This means that

Travelocity in Canada acts as a portal for Exit.ca, and acts as a true browser based tour shopper for one operator – Conquest.

### **3.1.9.2 Sabre Travel Network - Sabre Tours**

Sabre Tours is a department of the Leisure division within Sabre Travel Network that serves larger tour operator suppliers for both countries. The solutions provided are products aimed at the higher end of the tour operator segment, and are designed to enable an operator to distribute their inventory to a broad travel agency audience in either Canada or the USA. The benefits to travel agencies are a common text based format from their Sabre screen, that can access and book real time inventory on a per operator basis. There is a large start up cost to join the system, and significant programming resources are required for implementation, so smaller operators are not attracted. For those operators that do participate the proportion of bookings they see via the GDS channel is anywhere between 40 and 85% in the US, and 70-85% in Canada <sup>67</sup>. There are five distinct product lines: Tourguide, Tourlink (Mark Travel), Tourlink (AA Vacations), Access Tours (SoftVoy@ge), and Direct Tours (Logibro). These products are text-based platforms that serve different tour operators with different needs.

They all provide the ability to merge passenger reservation data back to Sabre's host PNR process. This allows the travel agency to account for the booking in their usual way, and to obtain productivity credits. However this line of products are not available via the Sabre browser based desktop environment, eVoya Webtop. In order to access Sabre Tours products, the agency must leave the browser environment, click on the Sabre host button and use text-based formats to shop for tours, and via the switches in Canada.

#### **3.1.9.2.1 US products:**

1. Tourguide – a Sabre developed application that provides common entries to enable agencies to make bookings with particular operators who host their own inventory such as GOGO, Mark Leisure Travel, Trafalgar Tours, (US points of sale and content only)
2. Tourlink (Mark Travel) – Mark Travel provides the common text front end that enables reservations across 16 differently branded operators, i.e. acts as a switch to its own

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<sup>67</sup> Data compiled from internal Sabre Holdings document

content. Sabre provides the travel agency community access to the Mark Travel application. Mark Travel houses the inventory. (US points of sale and content only)

3. Tourlink (AA Vacations) – American Airlines provide the common text based application for automating bookings on AA vacations only product, i.e. acts as a switch to its own content. (US points of sale and content only)

### **3.1.9.2.2 Canada products**

1. Access Tours – Sabre provides access to the switch Access tours, which is SoftVoy@ge technology that houses the common screens. Access does not host the inventory; each operator does so. (Canada points of sale and content only)
2. Direct Tours – Sabre provides access to the switch; Direct Tours is Logibro technology that houses the common screens. Direct Tours does not host the inventory; each operator does so. (Canada points of sale and content only)

### **3.1.10 Performance Analysis**

The firm has made significant restructuring efforts each of the last few years, including going 100% public, so direct comparisons between business units is difficult. The main revenue driver for the company remains its travel agency services. Despite significant turmoil in the industry, the company has posted consistent annual revenues of approximately \$2B USD each year since 1999, and net revenues of approximately \$2.5M USD since 1999 as well, see figure 2. Sabre Holdings regularly receives industry awards. For example, in 2003, Fortune magazine ranked Sabre as the eighth most admired firm in computer and data services. Consumer reports ranked Travelocity as the best place to book online air tickets, and in 2002, the World Travel Awards recognised Sabre as the worlds' leading CRS/GDS for the ninth year in a row.



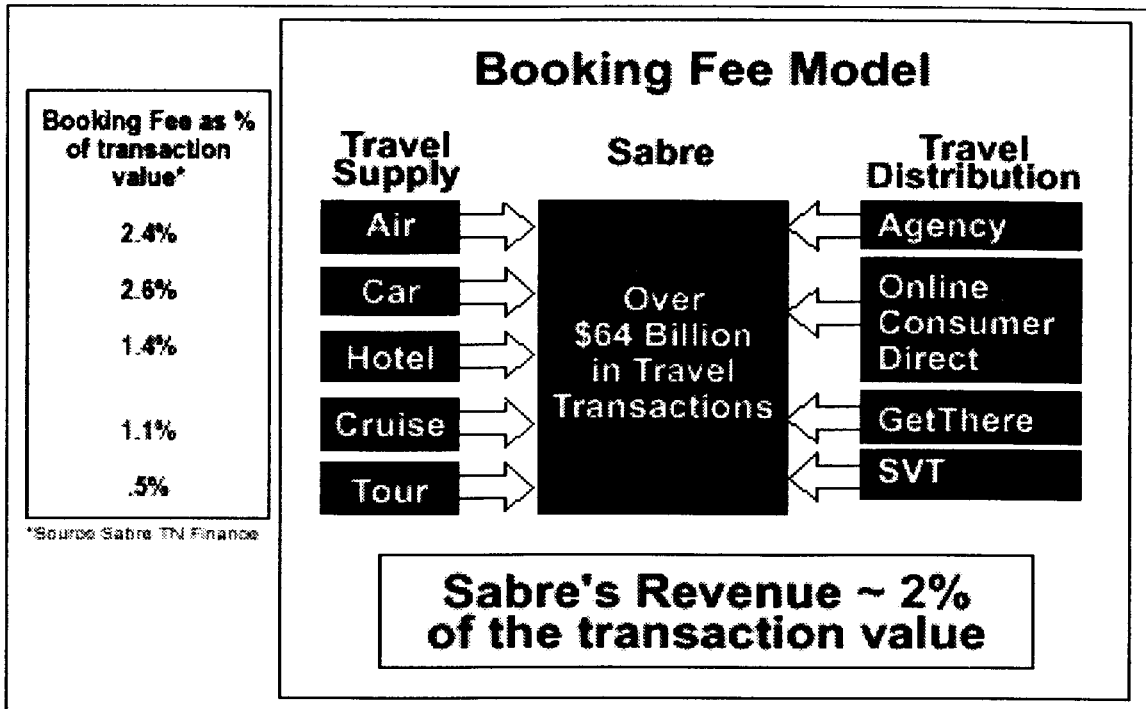


Figure 22: Sabre's Revenue Performance

Source – Sabre Holdings, copyright

Tour performance has traditionally been a small but steady contributor for Sabre Holdings, though it has declined against the high point of 2000. Tour operators pay for distribution via the GDS/agency channel, on a 'per booking' fee basis. The GDS earn on average \$7 USD per booking made, and the switches in Canada earn between \$1-8 per booking from the operator, plus sometimes a revenue share with the GDS. Figure 4 below shows the number of Sabre tour bookings per country, made by travel agencies, since 2000. The 2003 numbers are year to date June 2003, and have nearly reached the total for all of 2002. This reflects the findings in section 2.1.4.2, that tour travel does not trend the same as 'air' travel in general. It is unknown how many bookings are being siphoned off to the other channels. Gross revenue to Sabre for 2002 in Canada is therefore in the region of \$1.75M USD, in the US was \$5.45M USD, earning approximately 20% operating margin before taxes. In total this revenue represents about less than 1% of Sabre Holdings total revenue.

It is difficult to collect accurate market share numbers but Sabre can deduce that for North American GDS bookings, Sabre likely has the highest market share at about 45%, Worldspan and Galileo at 20%, and Amadeus at 10%.

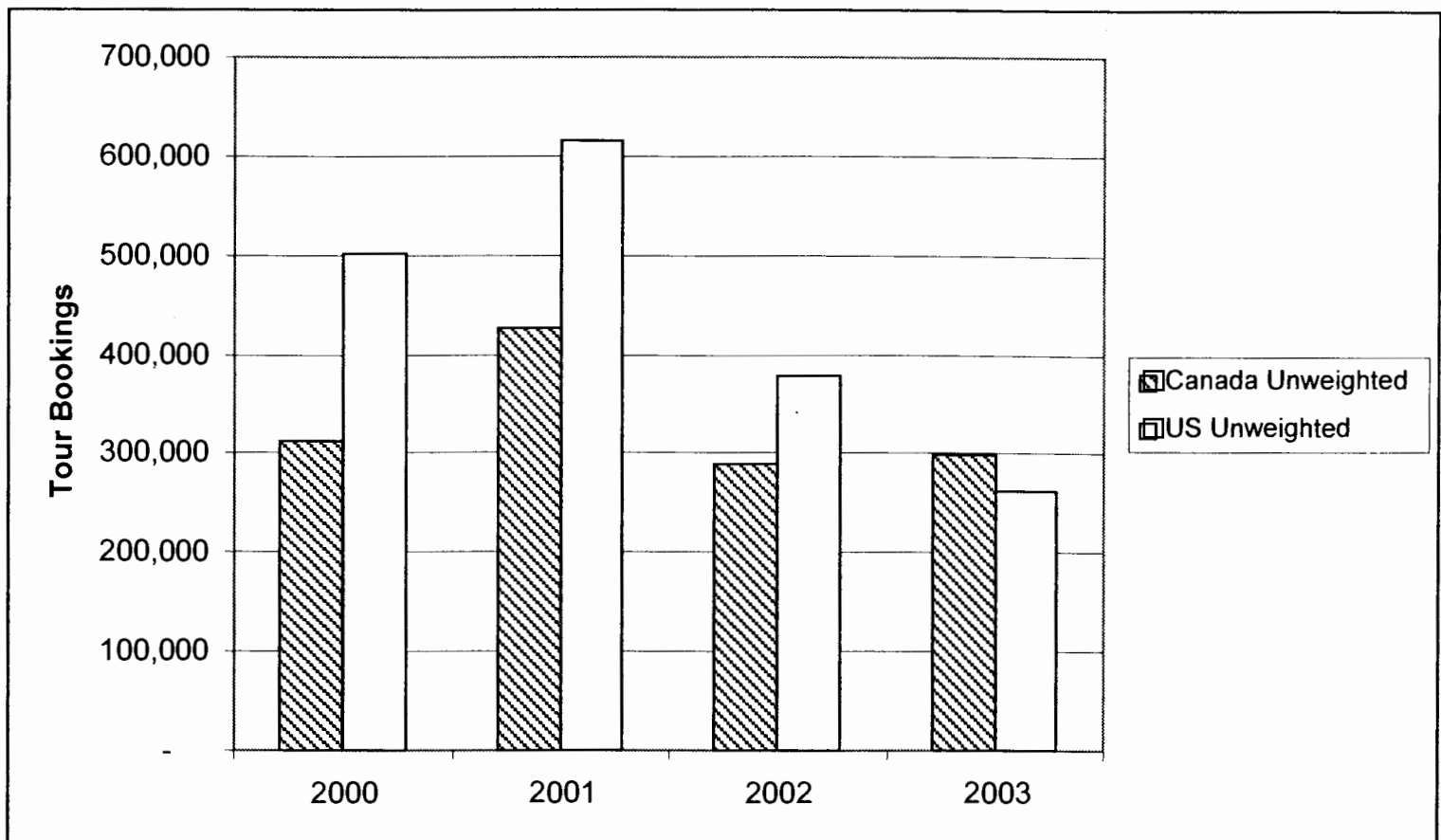


Figure 23: Tour Bookings

Figure by author; data compiled from Sabre Holdings 2002 tour booking report 2002

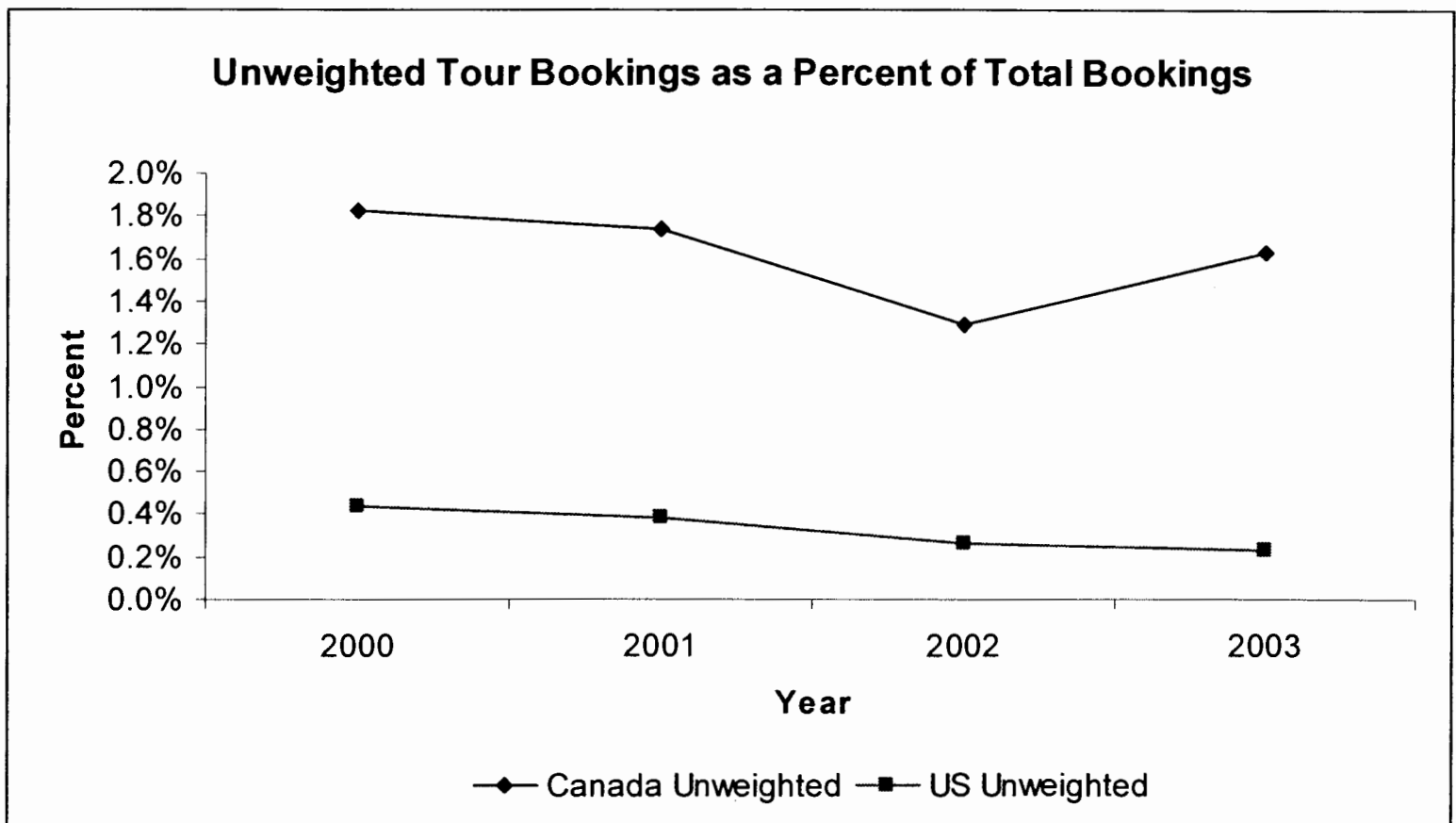


Figure 24: Unweighted Tour Bookings as a Percent of Total Bookings

Figure by author; data compiled from Sabre Holdings 2002 tour booking report 2002

Of interest is that whereas travel bookings in general reflect the differences in the size of the country's markets (i.e. Canada is about 10% that of the USA), this does not hold true for tour bookings. In Canada, the tour bookings are a disproportionate number of overall bookings compared to the US. That is the value of tour bookings to Sabre is higher in Canada than it is in the US. This can be attributed to the many different conditions in the market, see section 2.1.3.3.

## **4 FULCRUM ANALYSIS**

The purpose of this fulcrum analysis is to assess Sabre's current performance as it relates to tour distribution in Canada. The fulcrum analysis summarizes the industry attractiveness and Sabre's competitive position into a matrix, shown as table 10. This matrix depicts Sabre's current relative competitive position in the tour distribution industry as well as the current attractiveness. Additionally, the matrix depicts the potential future positioning of Sabre, and the future attractiveness of tour distribution. In order to reach the matrix shown in table 10, it is important to summarize the parameters used to discover the attractiveness of the industry and Sabre's competitive position.

### **4.1 Tour Distribution Industry Attractiveness**

The parameters for Canadian tour distribution industry attractiveness are shown in table 8. These are the market growth rate, the overall market size, (from the Sabre Holdings corporate viewpoint), and from the Porter's five forces analysis - profitability and the amount of rivalry. Another important consideration here is whether GDS participation in tour distribution is a factor for an agency renewal, the cornerstone of Sabre Holdings' desktop market share and revenue. The highest weighting applied here reflects that for Canada, the agency ability to make GDS tour bookings are a significant factor in their choice of GDS contract. Tour bookings are a more significant component for an agency than in the US, see figure 24, and that the market conditions favour automated agency tour bookings. This means that a tour booking solution is an important consideration in gaining a renewal or prospective account. See section 3.1.9 for a description of the relative values that tour-booking functionality has in Canada, versus the USA. However, from the corporation's point of view, Canada may be a significant market, though is a small one, so the attractiveness weighting is relatively high compared to profitability. That is for the firm to consider the attractiveness of the Canadian tour distribution industry it will likely weight the size of the market higher than the potential for profits because of the scale of these parameters.

<b>Assessment of Canadian Tour Distribution Industry Attractiveness</b>					
<b>Attractiveness Parameters</b>	<b>Weighting</b>	<b>Comment</b>	<b>Attractiveness</b>		
			<b>Low</b>	<b>Medium</b>	<b>High</b>
Market growth rate	10%	4% pa North America	0	3	0
Market Size	30%	Canada	2	0	0
Industry profitability	10%	Good	0	0	4
Rivalry	20%	HIGH	1	0	0
Ability to Influence GDS renewal	30%	Important	0	0	5
<b>Account Score</b>	<b>100%</b>		<b>0.8</b>	<b>0.3</b>	<b>1.9</b>
<b>Rank</b>			<b>2</b>	<b>3</b>	<b>1</b>
<b>Notes:</b>					
Each 'Attractiveness Parameter' is scored from 0 to 5, where 1,2 are ranked as Low, 3,4 ranked as Medium, and 5 is Highly attractive					

Table 7: Canadian Tour Distribution Industry Attractiveness

*By author*

So this project would rate the Canadian tour distribution industry overall, as 'highly attractive', especially because of its ability to influence the GDS contract renewal and despite the small size and limited returns (for tour) it could expect.

## **4.2 Sabre's Competitive Position**

The parameters for STNs' competitive position come from an understanding of the importance of desktop market share to Sabre Holdings, brand equity as it relates to an agency trusting that Sabre will continue to innovate, Sabre's ability to actually deliver innovative solutions (reinforcing that trust), and whether Sabre is a cost effective method for operators to distribute their product. Table 9 shows these for the Canadian Tour distribution industry with a weighting per parameter. The weightings reflect that Sabre's need for desktop share is paramount, and that the ability to offer value to operators (on a cost basis), is a close second. Brand Equity and Innovative solutions are weighted accordingly.

Sabre's Competitive position within the Canadian Tour Distribution Industry					
Competitive Parameters	Weighting	Comments	Sabre's Competitive Position		
			Weak	Medium	High
<b>Competitive Parameters</b>					
Desktop Market Share	40%	Provides reach for Operators	0	0	5
Brand Equity For agents	10%	Trust Sabre Solution	0	3	0
Innovative Solutions for Tour Booking	20%	Text based formats	1	0	0
Cost Effective for Operators	30%	A weak score means GDS bypass becomes more attractive	1	0	0
<b>Account Score</b>	<b>100%</b>		<b>0.5</b>	<b>0.3</b>	<b>2</b>
<b>Rank</b>			<b>2</b>	<b>3</b>	<b>1</b>

**Notes:**

Each "Competitive Parameter" is scored from 0 to 5 where a score of 1,2 means Sabre competitive position is ranked as weak for this parameter, 3,4 Sabre is ranked as Medium for this parameter, and 5 means Sabre is ranked as Highly competitive for this parameter.

Table 8: Sabre's Competitive Position

*By author*

So this project would rate Sabre's Competitive position within the tour distribution industry as 'highly competitive'.

### 4.3 Fulcrum Analysis

The matrix built from combing these parameters constitutes a fulcrum analysis shown on table 10. This table shows Sabre's competitive position is high in a highly attractive (to Sabre) industry at the present time, t. The current initiative of a) managing to one product and b) 10% ownership in Accovia will take an unknown amount of time to deliver a solution. Meanwhile, there are new entrants enabling online reservations, sometimes as a GDS bypass (e.g. SoftVoyage SIRRVA project), and sometimes as an agency bypass (e.g. Conquest's API for Travelocity).

Therefore, it is reasonable to assume that some bookings will be siphoned away from agencies as they are offered simpler, graphical shopping tools that can involve a GDS bypass (except for example, the Transitours option –see the competitive matrix table 15, appendix A.) Therefore the future position is likely to be weaker in the future. The market will experience some growth between now and 2007, but is becoming more competitive, so for the agency channel, it is a less attractive space in the future than currently. This is represented by t +1E on the matrix. That is the current strategy will move Sabre’s competitive position into a weak position in a less attractive industry in the future. The STN preferred (desired) outcome is to have a high competitive position in a less attractive (more competitive) market, and is shown as t +1D. The ability to prevent bookings migrating away from the agency channel represents a profitable opportunity as well as reinforcing the relevance for Sabre GDS for ‘regular’ agency business.

<b>Fulcrum Analysis</b>			
<b>Industry Attractiveness</b>	<b>Sabre's Competitive Position</b>		
	<b>HIGH</b>	<b>MEDIUM</b>	<b>WEAK</b>
HIGH	t	0	0
MEDIUM	t +1D	0	t +1E
LOW	0	0	0

**Notes:**

t is time now

t +1 is future time

E is expected outcome with current strategy

D is desired outcome with recommended alternative

Table 9: Assessment of Current Situation

*By author*

Therefore, the strategic alternative selected by this project should help STN move to the desired position (t +1D), over a short period of time.

## **5 SOLUTION ANALYSIS**

### **5.1 Forces and Scenarios**

Sabre Holdings have been using scenario planning since 1998, as a process for scanning the macro environment for forces and triggers that indicate a certain evolution is occurring. The end states are described at the industry wide level, and are given names for ease of identification, though their meaning is not necessarily obvious. The triggers are individual events at a business level and can be weighted as high, medium or low, according to their ability to influence the development for a particular scenario's end state. Sabre has identified four end states, and the triggers that positively affect the development of each end state. Table 11 (below) provides the end state names and examples of triggers per scenario.

#### **5.1.1 Description of Scenarios**

##### **5.1.1.1 Portal Power**

This is the name given to an end state where airlines use their strengths via worldwide alliances and deploy powerful technology that pulls travellers towards online portals. Key examples include airlines that offer exclusive inventory on their portals only. The best example of an activity that has moved the industry in this direction is the rise of Orbitz in the USA. Orbitz has had access to 'web only' fares and inventory (from its' airline owners) that has not been available on the GDS/agency channel, and captured significant revenues as a result. Another example is Air Canada's recent (May 2003) launch of an 'agent only' site with commissions for fares and inventories that are not available on the GDSs.



### **5.1.1.2 Solidarity**

Solidarity is the name given to an alignment between agencies and the GDSs, where each can leverage their respective CRM (customer relationship management) information, and technology, and create a new equilibrium. A current example includes the recent GDS initiative to present a discounted fixed price for a three-year term to the airlines in return for all of their content and fares. Sabre's initiative here is called the DCA3 agreement see section 2.1.6.1 for a description of this tactic in terms of mitigating deregulation and its ability to prevent GDS bypass. If the airlines sign up for these types of arrangements it will reduce the probability of portal power, by taking away exclusive inventory. The end state for solidarity is the preferred one for the GDSs – they will emerge from this period of high uncertainty with renewed strength, albeit with less pricing power. The impact on tour distribution would be similar: the agency channel will be a viable means for distributing a large proportion of tour content.

### **5.1.1.3 Newcomers**

Large media firms are the new 'barbarians at the gate', which means that these are 'new to travel' players, who may be able to introduce an innovative (especially leisure) business model. The media/entertainment firms will enter the travel industry probably via mergers and acquisitions, in order to leverage their customer base and infrastructure. In early 2003, USA Interactive (now called InterActiveCorp) purchased the remaining shares in Expedia, the online consumer travel service, and Hotels.com. The end state here is that new entrants are able to drive transformation, not the GDSs. The effect for tour distribution via the GDS/Agency is similar – a decrease in the viability of this channel, though for Sabre Holdings it could cause a spur in development of its' Travelocity business.

### **5.1.1.4 Global Cocooning**

This scenario describes the end state when an economic cataclysm and/or terrorism lead to global depression and consistently reduced travel demand. That is, socio-economic retrenchment drives transformation of the industry, not the GDSs. Some of these events have been seen recently, such as terrorism that inhibits travel, the impact of SARS (Severe Acute Respiratory Syndrome) on travel to Asia, strict security requirements impede travel so that there is substitution of teleconferencing for air travel. Many suppliers have trimmed capacity, and in the US there is a decline in ARC accredited agencies year over year (not so in Canada). The end state here is that there is widespread consolidation among many travel players, include those in

tour distribution, and these survive on reduced revenue streams. The effect for tour is similar: reduced demand causes consolidation, and fewer revenues.

Based upon the accumulation of triggers to date, the two most likely scenarios to hold sway for the next few years are solidarity and portal power. Clearly the entrance of InterActive Corp. into the online agency arena is a significant event, but the other triggers for this scenario do not add enough momentum to consider that newcomers will become realised. Global cocooning is also less likely as the World Health Authority begins to lift its ban on those cities most affected by SARS (such as Toronto, Beijing and Singapore), and the US economy has begun to show some positive signs in the 2<sup>nd</sup> quarter of 2003.

In June 2003, Sabre Holdings successfully signed four large US carriers to its DCA3 agreement. This agreement provides for a discount of about 12% on average per GDS booking, in return for all fares and inventory, including web fares. This is a positive signal that promotes solidarity, and reduces the probability for portal power.

## **5.2 Strategic Alternatives for Canada**

This project will examine a number of alternatives for Sabre Travel Network (STN) to compete for tour bookings in Canada, via the agency channel. The alternatives are considered as if solidarity is the dominant end state, and then re-examined per scenario thereafter.

### **5.2.1 Current Strategy: 'Manage to One' Solution**

#### **5.2.1.1 Alternative one**

See section 3.1.5, for a description of the current strategy and initiative for Canadian tour distribution. The current strategy calls for a reduction from 5 text based products, to one graphical product when Sabre is able to build a 'super PNR', for integration with other enterprise systems. It also calls for status quo in the company's ownership in Accovia in Canada.

### **5.2.2 Shopper on the Desktop**

#### **5.2.2.1 Alternative two**

This is a graphical user interface (GUI) that resides on the Sabre agents' desktop as an icon on the desktop application called eVoya Webtop. The icon is a link to an application that

searches the content in the switches, collects and presents options back as graphical information. This alternative proposes that Sabre Travel network will build an application that is a graphical shopping tool for ease of use by the Sabre connected travel agency, from their desktop. This would enable Sabre connected travel agents to shop across tour operators, in one entry, and make bookings graphically, using the Sabre desktop. There are no requirements for change among the tour operators or the switches; the booking is handled in the same way as today. There is no training that would be required for the travel agents' as they are familiar with the WebTop application, and the content provided by the switches.

The tour operators have not responded favourably to this notion in the past. Much of their marketing activity is directed toward educating agencies about the unique characteristics of their product line, standards of pre and post agency sales service, as well as standards and expectations for the end consumer. The agents are rewarded by their productivity with commissions, overrides and personal incentives, sometimes such as free trips for example. Providing ease of cross shopping has historically posed two risks for operators. These are that they will a) lose their ability to influence agency choices at the point of sale, and b) risk their price premiums for their marketing efforts. Shopping by price may become the chief parameter, and depress margins further. However, since 2001 business conditions such as soft demand and intense competition have caused tour operators to re-examine their position with all channels of distribution, including low cost online options, which are not yet fully functional. The proposed Sabre alternative outlined here may not meet the same resistance from operators that was once historically true. This option will not substantially change the booking process or fees per se, but may help to reduce the overall tour operator costs of distribution. An ability to improve agency adoption of automating bookings may reduce costs that operators have for fulfilling their sales via call centre bookings.

The switches would likely react favourably as there is no substantial change to the model, or their costs. They are free to continue with their current efforts among the charter airlines and tour operators, including GDS bypass (such as by building a website directly from an operators inventory).

The agencies are likely to react favourably. For several years Sabre has canvassed them for their 'top needs', and a graphical tour shopper is always identified.

## **5.2.3 Merchandize and Bypass**

### **5.2.3.1 Alternative three**

This alternative requires deploying resources in Canada to develop a new business model, and sufficient funding from headquarters to develop an application, in order to access the best content and bypass the switches. There are two dimensions.

#### **1. Merchandize content**

A new, internal department within Sabre Travel Network in Canada is formed to negotiate the best merchant rates with wholesalers (for FIT), and Tour Operators (for packages), leveraging Sabre's desktop reach in Canada (nearly 60%). That is, STN in Canada mirrors the merchant activities performed by the US based hotel merchandizing group, and applies this expertise to the tour operators in Canada. Sabre aggregates the content at the best rates from each operator who will participate, and acts as the merchant by paying the commission to agents.

#### **2. Enabling Technology**

The enabling technology is a common Application Protocol Interface (API) from a third party that has its own relational database, with application modules, that is able to search multiple databases. This would provide the ability to shop and book over different data structures among the tour operators, and present back to Sabre in a standard format. The switches are bypassed as the search goes straight into the tour operator data. Sabre would need to develop a presentation layer for its eVoya desktop, and a browser based presentation for its agency websites. This means an agency with Sabre connectivity will have access to merchant tour content on a graphical user interface that provides cross shopping and rich content, from their desktop, and from the agency's own website for a consumer booking tool.

The tour operators may respond unfavourably to this notion as they risk losing their ability to price their product at the retail level. There will be discussions over how much inventory to make available via merchandizing, and whether they are able to maintain or improve their margins via this method. However, the lower price points may be offset by the reduction in operator overall fees without payments to the switches. The first mover into this space may have an advantage with a lower price point in the agency channel which may drive volume, a reduction in operating costs (no commission payments across a multitude of agencies), and lower per

booking fee because of the switch bypass. In addition they are sure of a quality assured booking process that is well integrated with an agents workflow. Sabre Travel Network may need to consider reducing its fees in order to secure the content at the best rates. The loss in transaction fee will be more than made up by the spread between the net rate and the retail rate to agencies, (the merchant model).

The switches will not respond favourably as this bypass will cause them to lose revenue for all the bookings made via this method. It will redouble the efforts of SoftVoy@ge who have taken some steps to be able to provide operators the ability to distribute online, without the GDSs. The switches have contracts with many operators for IT services, which may be used as a lever to dissuade an operator from this alternative. Alternatively the switches may choose to lower their fees to the operators and so make this alternative less attractive.

The agencies will react favourably as they will benefit from an easy to use, graphical shopping and booking tool at their desktop, plus the lowest rates on packages versus an alternate channel.

## **5.2.4 Ownership in a Chosen Few**

### **5.2.4.1 Alternative four**

This alternative recommends taking ownership in a number of tour operators, and thereby taking control of a significant portion of Canadian tour operator distribution away from the switches. This alternative has three dimensions: Sabre would purchase a majority share in two or more of the largest (available) tour operators, in order to merchandize their content, and use technology to control distribution via the agency channel, without the switches.

1. Purchase a majority share in two preferably three, tour operators.

Of the largest five operators in Canada, four are owned by large corporations, see table 2. There is no reliable information for Canadian market share of the operators by channel, so this project assumes that Sabre's overall market share lead is a proxy for current tour booking market share. That means the "big five" players in question control more than half of the revenue available for tour bookings via the agency channel. Conquest is the only large player that is majority privately owned (Mark Travel, an important STN customer in the US has a 49% stake), but if owned with a number of smaller operators, would account for a sizeable share. A majority purchase would include a meaningful presence on each board of directors, and is preferred to a

strategic alliance for issues of control. The tour operators may not react favourably to giving up part of their ownership. However, they are in an intensely competitive market where demand is soft, fixed costs are high, and failures are not uncommon. A review of the financial status of several operators may reveal opportunities for Sabre to exploit. The cost of distribution will be lower without the switch fee, and Sabre would be motivated to provide a revenue share between the operators it has ownership in, and the distribution fee. STN would need a careful plan to mitigate any potential negative consequences from the other big four operators, who may be able to influence bookings among favoured retail chains.

## 2. Merchandize content

Sabre Travel Network in Canada establishes a member on each board of directors, and a team internal to Sabre work with the operators in rationalizing their product offerings, and providing the lowest rates to Sabre. Sabre acts as the merchant by paying commission to the agency directly.

## 3. Enabling technology

The enabling technology is a common API that sits on top of the legacy systems and is able to present a result set to a GUI on the desktop or a browser for the agency owned websites. Such a technology exists in the form of TAP, the protocol that ITA Software owns and Accovia have the sole distribution rights for in Canada. Sabre will be unlikely to be able to leverage a 10% ownership in Accovia to have unlimited access to TAP, so a preferred route would be to outsource this development to a third party. A readily available common API on a relational database may provide a starting point for this development. The next phase would require Sabre to develop a presentation layer for its desktop and agency websites.

Presumably the tour operators that Sabre has a controlling investment in will be cooperative. The operators that Sabre does not invest in will react unfavourably, and may threaten to withdraw from GDS tour distribution. This is mitigated somewhat by the fact that at the current time while every operator is searching for ways to bypass the GDSs, this channel is still the most effective for them. In Canada, unlike the US, the operators are still dependant on the GDSs for the majority of their distribution - 80% of tour bookings are made via travel agencies and about 80% of those are automated via the GDS/switch.

There is a significant risk to Sabre's main air, car, and hotel GDS booking functionality, however. If First Choice PLC and Transat A.T. Inc perceive that they will lose control over pricing their tour products they may threaten to take away their retail and tour bookings. Transat have about 650,000 non-tour segments with Sabre Travel Network annually (worth about 3 points of market share, and about \$2.25M USD in gross revenue), while First Choice may take Signature's tour bookings out of the GDS channel altogether (worth about 18% of Sabre's total tour revenue or \$280,000 USD), assuming they were able to replace the GDS.

The switches will react unfavourably as they are bypassed. Again, a firm like SoftVoy@ge may redouble their efforts at providing online low cost distribution for other operators, which will increase the competitive pressure on all players. Accovia may become motivated to deliver on its promise to use TAP effectively for the benefit of operators who wish to bypass the GDSs.

The agencies would likely react favourably. They have access to low priced content, paid from one instead of three or more sources, and are provided with a tour shopper and booking tool on their desktops and websites.

## **5.2.5 Leverage Travelocity.ca**

### **5.2.5.1 Alternative five**

Travelocity.ca has two methods of gathering and distributing tour products: one is a link (Exit.ca), and the other uses an API from Conquest to search and present that particular operator's content on the website. While this is not a complete range of product, it is significant because it does represent two of the five largest players' content. This alternative recommends that Sabre Travel Network be able to link Travelocity from STNs' agent website product, Sabre.Res. This means that agencies with the .Res product will enable their consumers to access Travelocity and its tour offerings.

The advantage for STN is that the agency channel will be motivated to make bookings on behalf of their consumers, or even encourage consumers themselves, with an efficient fulfillment process. The booking is sold on an agency website, is transacted on the operators database via Travelocity, bypassing Sabre and the switch, but the PNR could be merged back to the Sabre host for agency actions such as accounting and ticketing. The advantage for the operators is for a lower cost of distribution, assuming they pay Sabre Holdings once (Travelocity and STN would need to split the revenue). The agencies with Sabre.Res would react positively as they would have access to shopping and booking of tour for their end customers, and would receive the

commissions for the sale. The switches would react unfavourably as there is a bypass of them in this circumstance.

There will be some development hours required to successfully link Travelocity.ca to the .Res product, but the real hurdles will be in the commercial agreements. Conquest and Exit.ca will not want to pay twice per booking (once to Travelocity and once to STN), and Travelocity is motivated to keep all the revenue and grow its channel, without revenue share with an agency presence. The number of STN agencies with Sabre.Res is relatively small; many agencies do not want their Internet identity closely tied to a GDS, so uptake of this product has been slow. STN may therefore need to allow the full distribution fee to remain with Travelocity.ca, not capture any distributor revenues, but provide this ability to the agencies as a value add in the monthly fee for the .Res product.

### **5.3 Evaluation Criteria**

In order to determine the criteria against which to evaluate the alternatives, a balanced scorecard is used. The balanced scorecard approach provides a snapshot of the firms' stated strategic objectives in terms of goals and measures of success, across four parameters. At the corporate level, Sabre has a vision to 'win an increasing share of traveller spend by transforming the business of travel'. The issue of addressable revenue as opportunity for Sabre to become a retailer (see section Sabre's goal is to become the most pervasive, and renowned travel company of the decade, and become the benchmark for ongoing successful company transformation. This means that Sabre wants to leverage its assets and drive the transformation in the industry to the solidarity end state. This is described in terms of Sabre Holdings' strategic objectives:

- ◆ Forge direct, loyal relationships with leisure and business travelers
- ◆ Understand, shape and influence travelers' product selection
- ◆ Leverage our worldwide distribution assets
- ◆ Lead transition to new travel commerce and distribution business models
- ◆ Extend leadership in providing value-added technology to customers.



For Tour distribution in North America, Sabre uses the STN and Travelocity Business units. The strategic objectives are a subset of the above corporate objectives and are described as:

- Travelocity: increase customer acquisition, and migrate to higher margin products via merchandizing and targeting the unmanaged business traveller
- Sabre Travel Network: target sustainable agency segments globally, leverage technology leadership, enhance supplier offerings, and increase merchant product sales.

The objective of this project is to evaluating a number of alternatives for Sabre Holdings to pursue, with respect to a particular line of business: the distribution of tour travel products in North America, and specifically for the agency channel in Canada. Thus, the measures of success that are relevant for this project are:

- ◆ Company earnings growth of 3 percent
- ◆ Company revenue growth of 8 percent
- ◆ Within Sabre Travel Network, drive Merchant Model into 45 percent of North American agency locations, resulting in 150,000 North American bookings, while expanding the business model outside of the U.S.
- ◆ Maintain 36 percent bookings share and retain 328 million bookings through the Sabre GDS and the agency channel.

So the criteria this project will use to evaluate the alternatives for STN tour distribution are as shown in Table 12. The first objective is to target sustainable agency segments, the significance of which lies in the belief that some segments will be more valuable over time than others. That means the segments that are shrinking will be less influential in the future, and to drive earnings growth will require a cost cutting tactic. For example, there is an decrease in the absolute number of mom and pop agencies year over year in the US (not so in Canada), so as this segment shrinks, cost cutting will substitute for increases in market share or revenue per agency.

<b>Business Unit</b>	<b>Strategic Objectives</b>	<b>Goals</b>	<b>Measures</b>	<b>Weighting</b>
<b>STN</b>	Target sustainable agency segments	Decrease costs by 3%	Earnings growth of 3%	15%
	Leverage technology leadership	Increase bookings by 8% Or increase margin per booking	Revenue growth of 8%	20%
	Enhance supplier offerings	Maintain Current Market Share for all bookings	Maintain 36% GDS booking market share	45%
	Increase merchant product sales	45% of agencies have merchant content to sell	45% of NA agency locations	20%

Table 10: Evaluation Criteria

*By author, data compiled from internal sabre Holdings documents*

The second objective is to leverage technology leadership, the purpose for which will be to increase bookings or revenue. This can be done by increasing market share, and thereby the number of bookings, or increasing the amount of revenue per booking as in the merchant model. To enhance supplier offerings means to be able to remain vital to suppliers for their distribution needs, i.e. maintain market share at the current levels, for all booking types. Finally to increase merchant product so that 45% of agency locations have access to such product, means that Sabre is able to gain more revenue per booking. The weighting reflects the relative importance of each objective and goal. Merchant model and technology leadership are weighted the same as there is some cross over there, whereas maintaining market share is heavily weighted as the cornerstone of Sabre's revenue and attractiveness to suppliers and tour operators.

Many of the balanced scorecard items can be used to build a strategic alternative evaluation matrix, see section 5.4.1. However, there are also latent needs that are not expressed as strategic objectives, or measured goals. Nevertheless these needs are understood at the 'ground level' as important considerations in any strategic decisions. There are benefits that may accrue to

STN incidental to the main strategic alternative choice, and there are risks that will be run at the same time. These may not always be measurable, but will be factored into the decision making process.

<b>FINANCIAL PERSPECTIVE</b>	
<b>Goals</b>	<b>Measures</b>
Improve Earnings	3% YOY
Improve Revenue	8% YOY

<b>CUSTOMER PERSPECTIVE</b>	
<b>Goals</b>	<b>Measures</b>
Enhance supplier offerings	Maintain market share for agency channel
Target sustainable agencies	Merchant content available for 45% of locations

<b>INTERNAL BUSINESS PERSPECTIVE</b>	
<b>Goals</b>	<b>Measures</b>
Leverage technology leadership	8% Revenue Growth YOY

<b>INNOVATION &amp; LEARNING PERSPECTIVE</b>	
<b>Goals</b>	<b>Measures</b>
Understand, shape & influence travellers' product selection	Merchant content for 45% of agency locations

Figure 25: Balanced Scorecard

*By author*

For example, if Sabre attempted to bypass the switches there is an unspoken risk that the switches will apply pressure to the operators to maintain their position in the value chain. The switches can move from a partner in the value chain to a competitor very quickly, and there is some evidence that they are doing this, see table 15 in appendix A for a description of SoftVoy@ge SIRRVA product. Similarly, if Sabre took an ownership position in a tour operator, the other supplier operators would regard Sabre as a competitor and review their relationship with the GDS, even if it was detrimental to their own costs. Meanwhile, in the current business environment, cost reduction is a major consideration for the suppliers and operators, and any alternative that STN chooses for tour distribution should meet this criteria.

The latent needs can be listed as the questions that will be asked before any recommendation can proceed.

Will the alternative -

- ◆ Influence agency GDS contract renewal?
- ◆ Influence competitor or supplier retaliatory behaviour?
- ◆ Influence costs for operators or suppliers to distribute?
- ◆ Influence the speed to market for an STN solution?
- ◆ Influence the impact on the internal systems?
- ◆ Influence the opportunity to capture addressable revenue?

The weightings for the latent needs are 15% each and in total represent 30% weight of the total decision. That is, the strategic objectives, measures and goals as shown in the balanced scorecard represent 70% of the factors that will be considered in the decision making process, and the latent needs make up the remaining 30%. Each alternative is scored across the goals and needs from 0 to 5, where 0 means the alternative has the lowest influence and 5 means that alternative has the highest influence on the goal or latent need. For example, alternative A1 scores 5 on its likely ability to decrease costs by 3%, thereby indicating that it will have a positive influence on this goal. Alternative 4 scores 0, meaning it will have a very low influence on this goal.

**Valuation of Alternatives**

Expressed Goals & Latent Needs	Weight	Sub-Weight	Proxy	Alternative				
				A1	A2	A3	A4	A5
<b>Goals</b>								
Decrease costs by 3%	<b>70%</b>	15%	Profitability	5	2	1	0	2
Increase bookings by 8%		20%	Profitability	1	3	5	3	5
Maintain Current Market Share for all bookings		45%	GDS Market Share	1	5	5	2	5
45% of agencies have merchant content to sell		20%	New Valuable Content	0	0	5	5	3
<b>Account Score</b>		<b>100%</b>		<b>1.4</b>	<b>3.1</b>	<b>4.4</b>	<b>2.5</b>	<b>4.1</b>
<b>Latent Needs</b>								
Influence GDS contract renewal	<b>30%</b>	20%	GDS Market Share	0	5	5	4	5
Influence competitor or supplier retaliatory behaviour		20%	GDS Market Share	4	4	1	1	3
Influence costs for suppliers or operators to distribute		15%	GDS Market Share / Profitability	*	3	5	*	2
Influence the speed to market for an STN solution		15%	GDS Market Share	0	5	2	1	3
Influence the impact on internal systems		15%	Profitability	5	1	1	1	1
Influence the opportunity for addressable revenue		15%	New revenue	0	1	5	3	3
<b>Account Score</b>		<b>100%</b>		<b>1.5</b>	<b>3.3</b>	<b>3.1</b>	<b>1.7</b>	<b>2.9</b>
<b>Overall Score (/10)</b>				<b>1.4</b>	<b>3.2</b>	<b>4.0</b>	<b>2.3</b>	<b>3.8</b>
<b>Rank</b>				<b>5</b>	<b>3</b>	<b>1</b>	<b>4</b>	<b>2</b>

**Notes:**

A1 – Manage to One

A2 – Shopper on the Desktop

A3 – Merchandize and Bypass

A4 – Ownership in a chosen Few

A5 – Leverage Travelocity.ca

All scores are from 0-5 where 0 means this alternative will not have a positive influence on the goals or needs, and 5 means the most positive influence.

Table 11: Evaluation of Strategic alternatives

*By author*

## 5.4 The Strategic Choice

The above matrix shows that alternative three has the highest scores in total for the goals and the latent needs. This means that “Merchandize and Bypass” has the best chance of helping Sabre reach its strategic goals, and fulfilling on the latent needs. It is not without risk of course: this alternative will not have a positive influence on retaliatory behaviour, which means that there is risk of the switches alienating the operators, the degree to which is unknown. It may not be a speedy solution - merchandizing operator content may prove to be a long and difficult endeavour. This project recommends “Merchandize and Bypass”, with the assumption that solidarity is the primary scenario end state. However, portal power is currently a strong contender for the end state, and if it were to become dominant it would cause a re-evaluation of the scores in the above matrix. Portal Power would receive a highly weighted trigger if exclusive inventory was made available by suppliers via particular portals, such as Orbitz or Air Canada’s agent only website. That is, if current initiatives such as Sabre’s DCA3 were unsuccessful, then portals would gather momentum and even tour operators may find such a capability. In that case, the ability for a “merchandize and bypass” solution to positively impact an 8% increase in bookings is diminished, while “leverage Travelocity.ca” becomes enhanced. Similarly, if exclusive content were available on portals, the merchandize and bypass would have a low influence on the opportunity to attract addressable revenue whereas leverage traveloidty.ca would have a high influence.

## 6 RECOMMENDATIONS AND CONCLUSIONS

The ability of Sabre to compete for tour distribution in Canada in the near future will hinge on two key findings:

1. The ability to find an innovative solution that competes with an upsurge in competitors for tour distribution development. To remain competitive Sabre needs to stem the flow of bookings that are at risk of moving off GDS, and going online direct.

2. In Canada the ability for Sabre to provide a tour booking solution is a relatively higher factor in the decision process for the GDS contract, than in the US. This means that an alternate GDS with a tour booking strategy may have a competitive advantage that is given a higher weighting than other GDS products.

Given the likelihood of a solidarity end state, this project recommends to merchandize as much tour content as possible, to bypass the switches. At a corporate level this is consistent with the vision to ‘win an increasing share of traveller spend by transforming the business of travel’. Merchandizing enables higher revenue per trip, and may provide extra addressable revenue opportunities by moving away from supplier payments and capturing consumer payments. The margins per sale are improved for Sabre, thus winning a larger share of the travel spend.

The timing may be right: the tour business is witnessing an upsurge of technology innovation with new players, and there are several mergers and acquisitions ongoing. As the established market leader for tour distribution in the country, there is an expectation that Sabre will react positively to the challengers. By aggressively approaching the tour operators to merchandize their content in return for a lower fee, Sabre sends the signal that it is serious about transforming the business of travel. This action itself is a trigger: a GDS travel intermediary takes an inventory position that reinforces the preferred end state scenario of ‘Solidarity’. Implicit in this recommendation is that some portions of responsibility for tour distribution in Canada, be held by STN in Canada.

The next steps should include a business case that determines the ROI for development costs and returns, the merchandizing risks rewards and timelines, and an appropriate organizational change.

## 7 GLOSSARY

	<b>Description</b>	<b>Comment</b>
API	Application Protocol Interface	Facilitates exchanging data between two or more different software applications; a type of middleware that allows data sharing across different platforms.
Budget Airline	A scheduled airline with either low fares, low costs or both, usually serving domestic routes for leisure and business travellers	Jazz, Zip, South West Airlines, Westjet
Business Traveller	A consumer required to comply with corporate travel policies	A company representative doing business in another city or country
Charter Airline	A company that operates aircraft under government regulations that do not oblige them to run to a pre determined schedule Primarily for leisure travelers from Canada.	Air Transat, SkyService
Consolidators	A firm that distributes distressed inventory for air inventory, usually at a net rate to a travel agent	Intair, The Holiday Network
EVoya WebTop	Sabre's desktop application	Merges Sabre host with Internet capability at the agency desktop
FIT, also know as Flexible Itinerary Tour, or Foreign Independent travel	A trip planned by a tour operator or wholesaler that combines individual components of a journey and is usually sold as one commissionable price. FIT can refer to a consumer who has purchased components themselves from many suppliers over many media.	FIT wholesalers such as Americanada, Intair, FunSun in Canada.
GDS	Global Distribution System	Sabre, Galileo, Worldspan, Amadeus
Ghost	A booking which is not live	
Internet Booking	A reservation made via the Internet	Travelocity, Expedia, a travel agency or an airline website
Leisure traveller	A consumer traveling for	



	reasons other than business	
Off Line agency	A retailer of travel components via every communication method.	Amex Corporate Travel Services. A mom and pop retail agency.
On Line agency	A retailer of travel components via the Internet. Fulfillment may be done elsewhere. For example Travelocity in Canada has its' sales fulfilled by an offline agent.	Travelocity, Expedia, Cheaptickets.com.
Online Direct	A supplier that distributes its own inventory via the Internet. Fulfillment may be a simple in-house process.	An airline that sells its inventory via its website, e.g. Westjet.
PNR	Passenger Name Record. The way the traveler and inventory information is confirmed and combined for invoice and itinerary purposes, on the GDS.	A Booking
Sabre.Res	The product name for STNs agency website	Co-branded for consumer bookings to be handled by an agency
Scheduled Airline	An airline company subject to government regulations that obliges services for domestic and/or international routes, for leisure and business travellers	Air Canada, US Airways, British Airways, Cathay Pacific
Segment	One leg of a journey that is confirmed and consummated as part of a trip	It represents a unit of inventory.
STN	Sabre Travel Network	The division in Sabre that serves the travel agency channel
Supplier	The provider of inventory	Air seats, cruise cabins, vehicle rentals, packaged holidays
Supplier Direct	A supplier that distributes its own inventory, or a tour operator that sells multiple suppliers' components via every communication method except the agency channel	American Airlines call centre sales of American Airlines tickets. Signature Vacations call centre sales for charter tickets.
Tour	Used interchangeably with package or vacation. Any aggregation of leisure travel products usually sold as one event.	An individual air ticket and car rental, or an all inclusive trip to Mexico for a family of four

Tour Operator	A reseller. A name used interchangeably with tour supplier, where components are packaged.	Signature, Air Transat Holidays, Air Canada Vacations.
Unmanaged Business Traveller	A consumer traveling on business but not required to comply with corporate travel policies	A business person visiting a supplier in another city or country

## 8 APPENDIX A

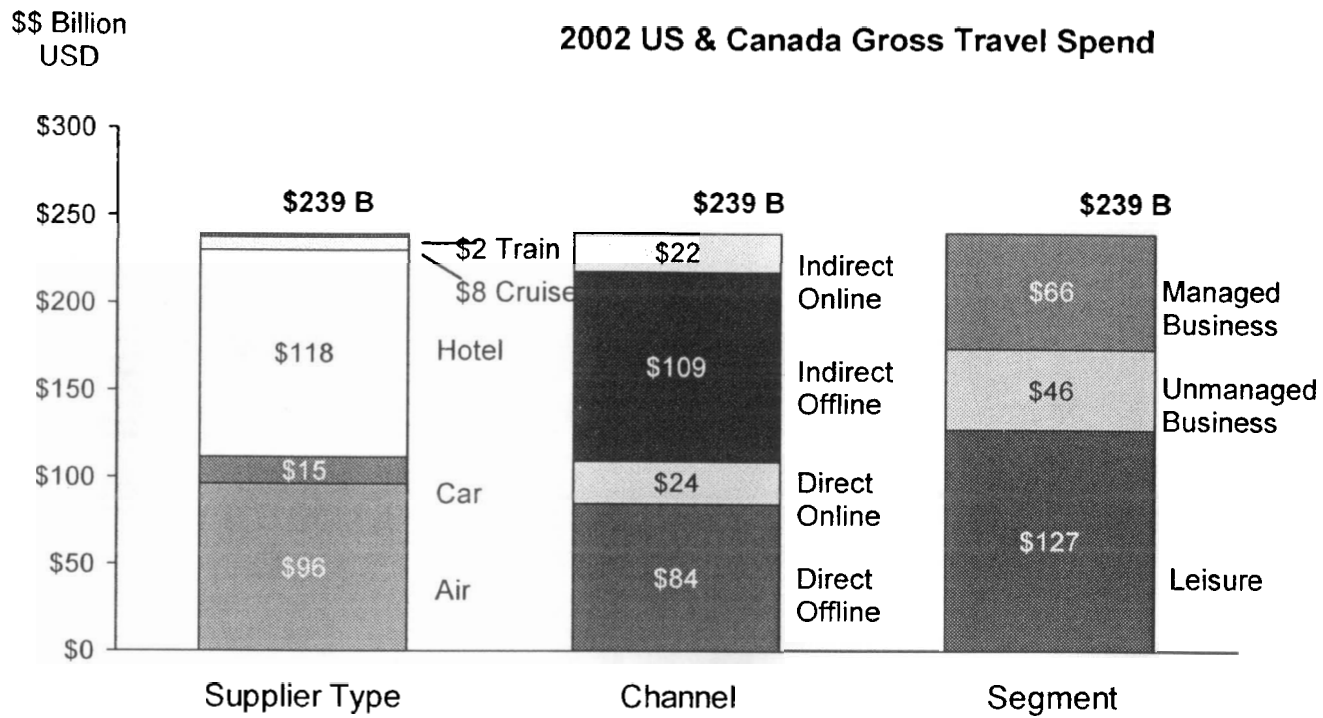


Figure 26: 2002 US & Canada Gross Travel Spend

Source: Sabre Holdings- copyright

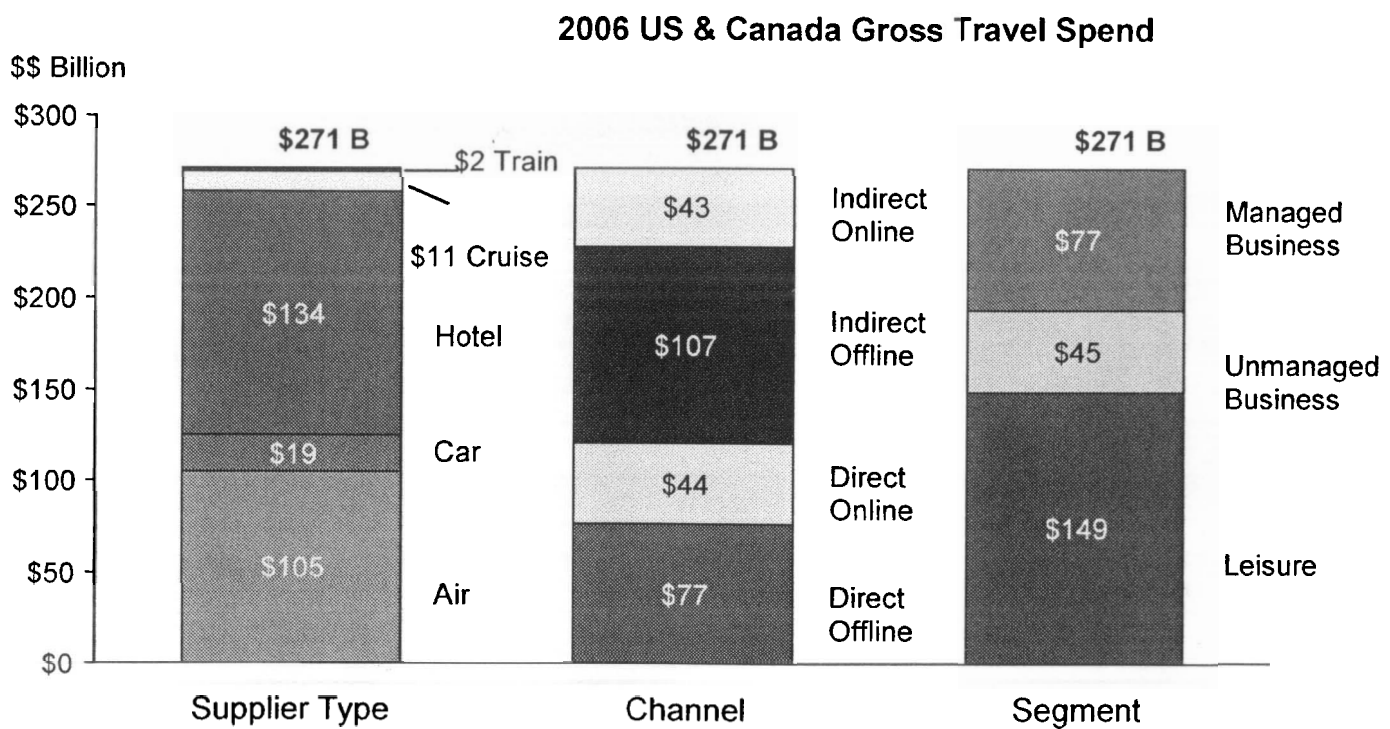


Figure 27: 2006 US & Canada Gross Travel Spend

Source: Sabre Holdings - copyright

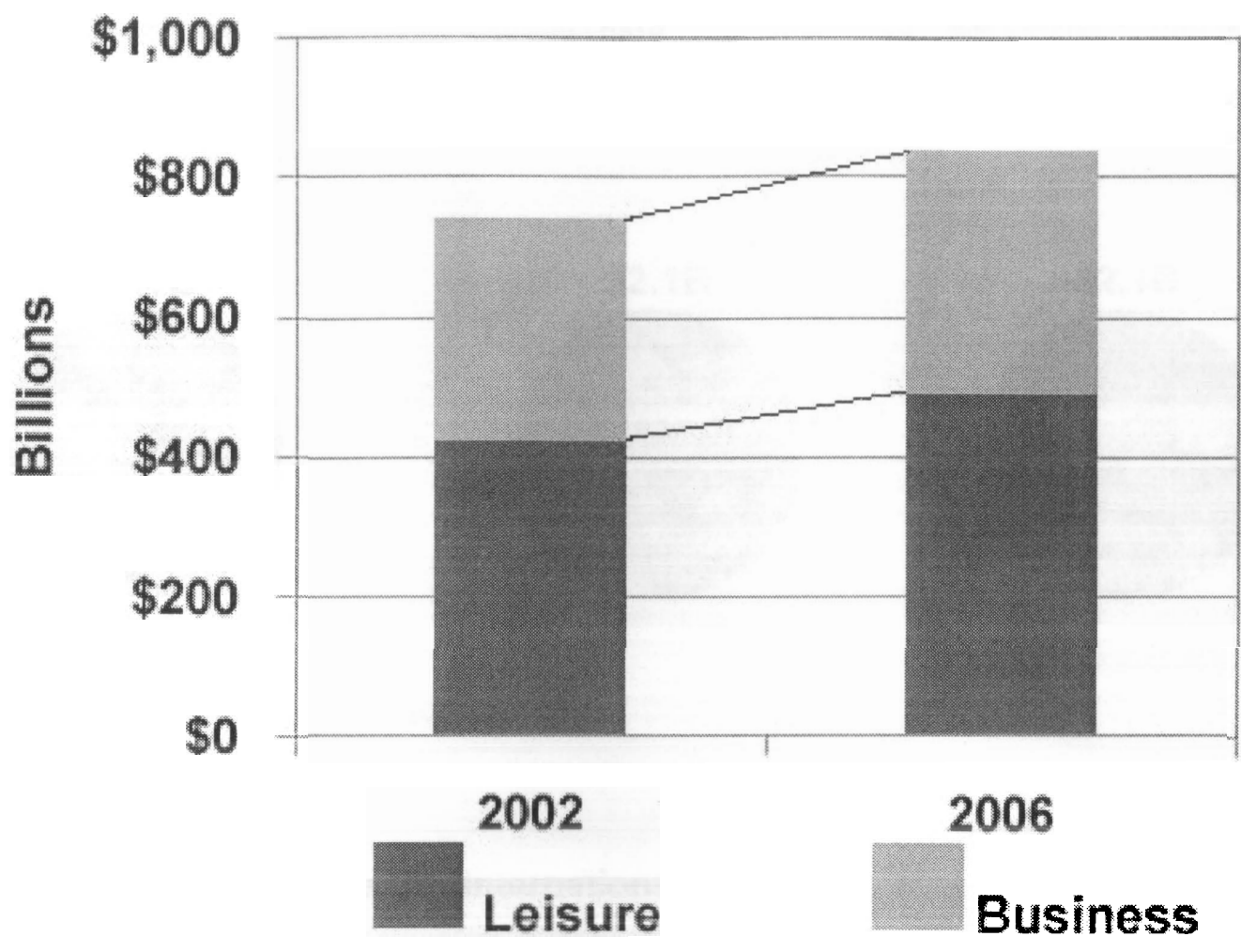


Figure 28: Travel Spend by Travel Category

Source: Sabre Holdings - copyright

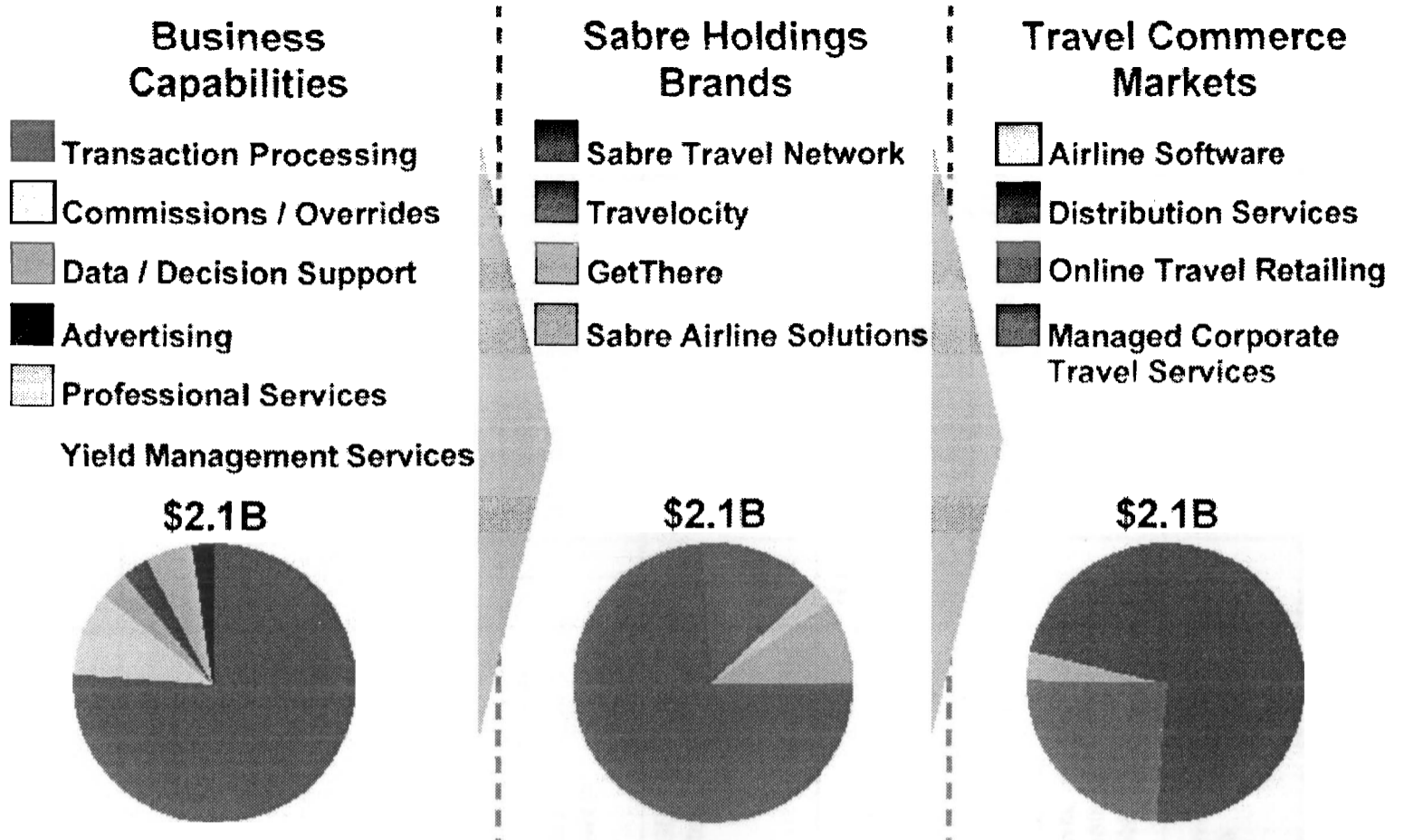


Figure 29: Participation in the Travel Market

Source: Sabre Holdings - copyright

**Canada Domestic/Transborder/International O&D**

Data is Apr02 - Mar03

All Canadian Market

Sum of Passengers	Type			
	Domestic	International	Transborder	Grand Total
Total	4,724,417	4,483,021	6,017,667	15,225,105
Percent	31.0%	29.4%	39.5%	100.0%

**AC Domestic/Transborder/International O&D**

Data is Apr02 - Mar03

Air Canada

Sum of Passengers	Type			
	Domestic	International	Transborder	Grand Total
Total	3,872,207	1,705,644	2,670,144	8,247,995
Percent of AC bookings	46.9%	20.7%	32.4%	100.0%
AC Percent of Total Canadian Market Bookings	82.0%	38.0%	44.4%	54.2%

Data reflects Origin & Destination level booking data

Table 12: Canadian Travel by Origin and Destination

Source: Sabre Holdings-copyright

Player	Ownership	Product Name	Suppliers	Customers	Revenue Source	Inventory Source	TEXT	GUI	Web Based	Shopping	Booking
Sabre Tours	Sabre Holdings	Directours/ Access Tours	Big 5	Sabre Agencies	Per booking from the operator	Ghost inventory via the switch	Yes	No	No	No	Yes
Galileo	Cendant	Leisure Shopper	Big 5	Galileo Agencies	Per booking from the operator	Ghost inventory via the switch	Yes	No	No	No	Yes
Logibro	Accovia	Directours	Tour Operators	All GDS agencies	Per booking from the operator plus revenue share from GDS	Ghost inventory via the switch	Yes	No	No	No	Yes
SoftVoy@ge	SoftVoy@ge	Access Tours	FIT Wholesalers	All GDS agencies	Per booking from the operator plus revenue share from GDS	Ghost inventory via the switch	Yes	No	Yes SIRRVA B2B with Galileo agencies	Yes	Yes
Travelocity	Sabre Holdings	Total Trip (US only)	US only	Travelocity Online Consumers	Mixture of individual suppliers per booking. Moving toward a Tour Operator by pass	Live GDS inventory	No	No	Yes	Yes	Yes
Conquest	Private and 49% Mark Travel (US)	Conquest	Canada only	Travelocity Online Consumers	Per booking fee from the operator	Via Conquest API to live inventory	No	No	Yes	Yes	Yes
Transitours	Private	Bookings	Big 5	GDS Travel Agencies	Per booking or monthly fee from agency	Ghosts inventory via the switches, presents to a website	No	Yes	Yes	Yes	No
Expedia	USA Interactive		Big 5	Expedia Online Consumers	Unknown	Accovia switch	No	No	Yes	Yes	Yes

Player	Ownership	Product Name	Suppliers	Customers	Revenue Source	Inventory Source	TEXT	GUI	Web Based	Shopping	Booking
Solars	Private	Solarnet and Tourtek	Big 5 and Niche	GDS Travel Agencies	Per booking from the operators	Can host live inventory	No	Yes	Yes	Yes	Yes
Comnet	Private	Navitour	Big 5	Sears Online Consumers	Per booking from the operators	Direct from the operator	No	No	Yes	Yes	Yes
Trip Central	Private	Trip central.ca	Switch operators	Online Consumer	Per booking from the operators	Ghosts inventory, via the switches	No	No	Yes	Yes	No
Exit.ca	Transat A.T. Inc	Exit.ca	Mostly ATH	Online Consumers & Travelocity	Internal charge	Live	No	No	Yes – a link for through traffic	Yes	Yes

Table 13: Canada Competitor Matrix

*By author*

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